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BANKRUPTCY REFORM ACT OF 1978 (FUTURE EARNINGS)

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS

OF THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

BANKRUPTCY REFORM ACT OF 1978

OCTOBER 29, 1981

Serial No. J-97-11, Part 2

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

88-761 O WASHINGTON : 1982

J521-311

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BANKRUPTCY REFORM ACT OF 1978
(FUTURE EARNINGS)

THURSDAY, OCTOBER 29, 1981

U.S. SENATE,
SUBCOMMITTEE ON COURTS,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:45 a.m., in room 5110, Dirksen Senate Office Building, Senator Robert Dole (chairman of the subcommittee) presiding.

Present: Senators Dole and Heflin.

Also present: Senator DeConcini and Francis C. Rosenberger, former staff member.

Staff present: Richard W. Velde, chief counsel; Douglas B. Comer, counsel; Arthur Briskman, minority counsel; Linda E. White, chief clerk; Will Lucius, counsel, Committee on the Judiciary; Boyd Hollingsworth, counsel, Subcommittee on Immigration; Lynda Nersesian, counsel, Subcommittee on Agency Administration; and Lillian McEwen, counsel to Senator Biden.

OPENING STATEMENT OF SENATOR HOWELL HEFLIN

Senator HEFLIN [acting chairman]. The hearing will come to order.

Senator Dole, the chairman of this subcommittee, is unavoidably detained. I have commented in the past that I believe he is the busiest man in the Senate. He is chairman of the Finance Committee and has a role of leadership in farm and agricultural matters, and in practically every issue that has been before Congress he has occupied a leadership role. He is now in the process of some matters that require his immediate attention, so he has asked me to go ahead and start the hearing, and I am delighted to do so.

He has an opening statement, which I will read.

[The prepared statement of Senator Dole follows:]

PREPARED STATEMENT OF SUBCOMMITTEE CHAIRMAN ROBERT DOLE

Today is the final day of hearings to be held before the Subcommittee on Courts of the Judiciary Committee on the subject of revision of the Bankruptcy Reform Act of 1978.

Hearings on this matter were previously held on April 3 and April 6 of this year, and at those hearings a number of changes were recommended by witnesses familiar with the problems which have been encountered by creditors, courts, and practitioners with the new code.

In July of this year, the Senate passed S. 863, a bill consisting primarily of technical amendments to the various provisions of the code which witnesses testified were necessary to clarify ambiguities, correct stylistic errors, and reconcile inconsistent sections.

Beyond technical changes that were needed in the code however, witnesses at previous hearings have detailed the need for revision of certain of the substantive provisions of the code which have interfered with the effective administration of the bankruptcy laws, caused inequities for good-faith creditors, and unnecessarily relaxed obligations placed upon debtors.

Areas of concern which the subcommittee explored at those hearings included such matters as the usefulness of the Federal exemptions, simplification of the discharge and reaffirmation process, revision of sections specifying the trustee's authority in voiding transfers of assets prior to bankruptcy, and similar matters.

The staff is now evaluating the testimony provided on these and other subjects with a view to determining what legislation will be needed to correct such problems as do exist.

Today's hearing will focus upon two remaining proposals which have been put forward by interested parties for consideration by the subcommittee which have not yet been the subject of extensive comment by witnesses. Those proposals basically revolve around the question of whether or not a "future earnings test" should be applied to the determination of whether or not a debtor filing for relief under chapter 7 of the Bankruptcy Code should have that relief available to him.

Many knowledgeable commentators upon the problem of abuse of the Bankruptcy Code have pointed to the provisions of the law which enable a debtor with substantial future earnings capability, but an excess of liabilities over assets on paper, to file for bankruptcy relief under chapter 7 of the code when that debtor nevertheless has the ability to pay the debts which he owes as they become due.

A proposal recently put forward by the National Coalition for Bankruptcy Reform, a union of representatives of consumer credit companies, credit unions, banks, retail marketers, and many other industry groups, would require the bankruptcy court to take the future earnings capabilities of the debtor into account in evaluating qualification for chapter 7 relief.

As a part of this proposal, it has also been recommended that the standard length of chapter 13 wage-earner plans be expanded from 3 to 5 years in order to allow for systematic recovery of a greater portion of debt than has been generally recovered under the present law.

The changes proposed would be far-reaching in their impact upon bankruptcy proceedings and the debtors involved and have drawn spirited comment from the judiciary and consumer groups.

In this hearing, the subcommittee will hear from representatives of the consumer credit industry, individuals who have conducted extensive studies of the financial status of persons who seek chapter 7 relief, representatives of various consumer groups, and members of the judiciary and academic communities.

Senator HEFLIN. To all of our witnesses today, I extend on behalf of Senator Dole a welcome.

While the potential impact of the proposals before us today upon bankruptcy courts, practitioners, and debtors is great, so also is the potential recovery which certain studies indicate could be realized for all credit consumers by the incorporation of a future earnings test in the law.

Estimates of losses which could be avoided through such a device range as high as $1.6 billion annually—$1.6 billion in savings to credit companies which could be passed on to all users of credit. Thus, it is with great interest that I convene on behalf of Senator Dole these hearings today to hear the pros and cons of this issue.

A few weeks ago, all of the witnesses appearing today were provided with a copy of the proposals which have been put forward by the National Coalition of Bankruptcy Reform. I would ask at this time that a copy of those proposals be placed in the record to follow this opening statement. Without objection, it will be included at this point together with a copy of my own and Senator Thurmond's statements.

[The prepared statements of Senators Heflin and Thurmond and a copy of the proposals of the National Coalition of Bankruptcy Reform follow:]

PREPARED STATEMENT OF SENATOR HOWELL HEFLIN

MR. CHAIRMAN, I APPRECIATE THE OPPORTUNITY TO PARTICIPATE IN THIS CONTINUING AND ESSENTIAL EXAMINATION OF THE STATE OF THE BANKRUPTCY LAWS IN THE UNITED STATES. SINCE MY COMING TO THE UNITED STATES SENATE, I HAVE BEEN MOST CONCERNED WITH THE RAMIFICATIONS OF THE 1978 AMENDMENTS TO THE BANKRUPTCY ACT. BASED UPON PREVIOUS HEARINGS OF THIS SUBCOMMITTEE AND INFORMATION FROM MY CONSTITUENTS, I AM VERY CONCERNED WITH THE RAPIDLY INCREASING RATE OF BANKRUPTCIES AND ANY POTENTIAL ABUSES OF THE PRESENT SYSTEM.

I COMMEND OUR DISTINGUISHED CHAIRMAN, SENATOR BOB DOLE, AND HIS MOST CAPABLE STAFF, FOR THE LEADERSHIP HE HAS DEMONSTRATED IN INVESTIGATING AND REVIEWING POTENTIAL LEGISLATION IN THE AREA OF COURT AND JUDICIAL REFORM. I AM AMAZED AT THE EFFORT AND PROGRESS THAT CHAIRMAN DOLE HAS MADE IN THESE AREAS, SINCE HE IS PROBABLY THE MOST BURDENDED SENATOR WITH HIS AWESOME RESPONSIBILITY AS CHAIRMAN OF THE FINANCE COMMITTEE AND HIS OUTSTANDING LEADERSHIP WITH THE AGRICULTURE COMMITTEE.

I AM DELIGHTED TO BE ABLE TO WORK WITH BOB DOLE IN THESE ENDEAVORS, AND THE SUCCESS ALREADY ACHIEVED IN PROCESSING TWO MAJOR PIECES OF LEGISLATION IN THE AREA OF BANKRUPTCY REFORM, S.1365, THE GRAIN ELEVATOR BANKRUPTCY BILL, AND S.863, THE TECHNICAL AMENDMENTS TO THE BANKRUPTCY REFORM ACT OF 1978. THIS LEGISLATION HAS PASSED THE UNITED STATES SENATE AND IS PENDING ACTION BY THE HOUSE OF REPRESENTATIVES, BUT I AM HOPEFUL THAT CONGRESS CAN ACT ON MORE SUBSTANTIVE CHANGES THAT WILL PLACE BANKRUPTCY LAW IN ITS PROPER LEGAL POSITION TO AFFORD APPROPRIATE ASSISTANCE TO THOSE INDIVIDUALS IN NEED BUT NOT TO BE USED AS A VEHICLE FOR ABUSES, NOT ONLY OF THIS LAW, BUT OF OUR FINANCIAL AND ECONOMIC SYSTEM THAT CAUSES HARDSHIPS ON OUR ENTIRE SOCIETY.

I THINK IT IS INCUMBENT UPON CONGRESS TO REVIEW THIS CON-

STITUTIONALLY MANDATED AREA OF THE LAW AND TO DETERMINE THE CAUSES AND EFFECTS OF THE INCREASE IN BANKRUPTCY FILINGS AND TO PROVIDE LEADERSHIP TO THE AMERICAN PEOPLE TO HAVE CONFIDENCE IN THE WORKABILITY OF THEIR LAWS AND OUR INSTITUTIONS OF GOVERNMENT. I LOOK FORWARD TO HEARING TESTIMONY, AND EXAMINING THE PROPOSALS BEFORE THE SUBCOMMITTEE TODAY. I AM HOPEFUL WE CAN DEVELOP MEANINGFUL LEGISLATION IN THE AREA OF "BANKRUPTCY REFORM" AND WITHOUT DELAY.

MR. CHAIRMAN, AGAIN, THANK YOU FOR YOUR LEADERSHIP IN THIS AREA AND I LOOK FORWARD TO CONTINUED EFFORTS IN THIS MOST IMPORTANT AREA.

THANK YOU MR. CHAIRMAN.

PREPARED STATEMENT OF SENATOR STROM THURMOND

MR. CHAIRMAN:

I would like to commend the distinguished Senator from Kansas (Mr. Dole) for his continued interest in examining the Bankruptcy Act of 1978. Clearly, this inquiry is necessary in order that the members of this Subcommittee, as well as the full Senate, may be properly informed about the issues involved in this law, which is not only intricate in its form but also far-reaching in its application.

Based upon the information which I have received, the subject of the hearing today is indeed a matter of great concern. I have heard from various sources that the 1978 Reform Act, along with advertising by attorneys, has created a system of easy access to personal bankruptcy that was never intended by Congress when it enacted the 1978 legislation. There was a great deal of testimony to this effect during the hearings on the subject before this Subcommittee in April. Also, no one can dispute the fact that the economy has had an adverse influence on everyone's personal

financial situation. However, there has been an increase in the number of personal bankruptcies, and it behooves us to attempt to correctly assess the cause.

In this light, I believe that one important question needs to be addressed. That question necessarily involves distinguishing consumers from debtors. All of us here are consumers; but we are all certainly not debtors in terms of the Bankruptcy Act, and this is what clearly needs to be defined, for relief under the law for a debtor in bankruptcy is not always synonymous with relief for the consumer. I seriously question whether what is good for a debtor is necessarily good for a consumer. After all, many consumers borrow money, purchase goods and services on credit, and participate in credit unions, but not all consumers petition for relief under the bankruptcy laws. Yet, the debt of those that are discharged in bankruptcy is eventually covered by someone, whether it is manifested in higher finance charges and interest rates, or worse yet, in the inability to secure loans at all.

I fear that unless this distinction is clearly defined, the style of life to which so many of us have become accustomed will be dealt a severe blow through a deterioration of our national system of credit utilization. We need to know if economic times have changed sufficiently to be reflected in our laws, and if this is the case, how it should be reflected. If this entails reassessing traditional concepts of access to bankruptcy, then so be it. We need to consider a system founded in fairness--not only to debtors and creditors--but more importantly, one that does not adversely affect the majority of people who are in neither category.

Proposals of the National Coalition of Bankruptcy Reform

PROPOSED LANGUAGE

Section 2

(a) Section 109 of title 11, United States Code is amended by adding the following subsection:

"(f) An individual may be a debtor under chapter 7 of this title only if such individual cannot pay a reasonable portion of his debts out of anticipated future income."

(b) Paragraphs (2), (3), and (4), of section 521 of title 11, United States Code, are renumbered as paragraphs (3), (4), and (5), and a new paragraph (2) shall be added as follows:

"(2) If the debtor is an individual, file a statement of income and expenses setting forth (A) the debtor's current income; (B) an estimate of the debtor's current expenditures for living expenses and the support of his family; (C) all income which the debtor reasonably expects to receive within the two years following the petition; and (D) all expenditures which the debtor reasonably anticipates he will have to make within the two years following the petition which are not included in subparagraph (B) above;"

(c) Section 342 of title 11, United States Code, is amended by adding the following sentence:

"The notice shall include a copy of the statement of income and expenses specified in section 521(2),"

(d) Section 305 of title 11, United States Code, is amended by adding the following subsection:

"(d) The court may dismiss a case under chapter 7 of this title upon the motion of any party in interest made not later than 30 days after the meeting of creditors, and after notice and a hearing, if the debtor is ineligible for relief under the provisions of section 109(f)."

EFFECTS OF PROPOSED LANGUAGE

1. Use of Future Income	Debtor is not eligible for chapter 7 if a reasonable portion of debts can be paid out of future income.
2. Effect on Debtors Who Can Pay Some Debts Out of Future Income	Debtor is not eligible for chapter 7 relief. Debtor may use chapter 13.
3. Effect on Debtors Who Cannot Pay Any Debts Out of Future Income	No change from present Code. Debtors will file chapter 7 petition, and all debts will be discharged.
4. Impact on Bankruptcy Filings by Persons Filing Bankruptcy Petitions Under Current Law	
(a) Clear ability to pay	Probably will not file. Creditors will object. Petition will be dismissed.
(b) Some ability to pay	Probably will file chapter 13
(c) Marginal ability to pay	Some will file chapter 13, but many will file chapter 7. Limited ability to pay will make creditor objection unlikely because of low potential return.
(d) No ability to pay	Will file chapter 7.
5. Treatment of Noncontractual, Business and Tort Debts	Affects all debts.
6. Procedure	Debtor files petition, and creditor must move to dismiss. Court not involved unless a motion to dismiss is made, and then, court only determines whether debtor has ability to pay debts out of future income.
7. Impact on Dischargeability Complaints and Reaffirmation Issues	May be expected to decrease because these involve attempts to reach future income. Debtors with substantial future debt paying ability will not be able to use chapter 7, so there will be less need for proceedings seeking to reach such income.
8. Post-Petition Change in Circumstances	Debtor denied relief can file new chapter 7 petition if circumstances change.
9. Effect on Court Process	Invites more extensive use of chapter 13. Will reduce filings as to those having ability to repay.

Senator HEFLIN. It is now my pleasure to call upon our first witness, Senator Dennis DeConcini of Arizona, who spearheaded the drive in the Senate in 1978 to pass the Bankruptcy Reform Act which is the subject of this series of hearings.

Senator DeConcini, we welcome you.

STATEMENT OF HON. DENNIS DeCONCINI, A U.S. SENATOR FROM THE STATE OF ARIZONA

Senator DECONCINI. Mr. Chairman, thank you very much. I appreciate the opportunity to share my observations with the subcommittee about the present state of the bankruptcy law. This was a subject that occupied a good deal of my time and that of the committee during the 95th Congress.

The result of those efforts was passage of the Bankruptcy Reform Act, now commonly referred to as the Bankruptcy Code, that went into effect on October 1, 1979. It represented a wholesale change in the law of bankruptcy, its procedures, and even the structure of the bankruptcy courts.

As with any major revision of a complicated area of the law, time and experience inexorably point out those areas where the law has worked well and those areas where our judgment and expectations have not matched reality.

The Bankruptcy Code is no exception. Its enactment was necessary and represented a large step forward in many respects, but its frenzied last-minute passage also resulted in numerous technical errors and policy misjudgments.

In that connection, Mr. Chairman, I want to commend you and the subcommittee for quickly acting on the bankruptcy technical amendments bill in July and for raising the substantive issues that are the subject of these hearings.

I feel today's hearings are proper and timely, but there are those who will claim that insufficient time has passed since enactment of the code to adequately assess the effect of various provisions and to propose major revisions. I disagree; we have now had nearly 1 million cases filed under the new code—surely an adequate sampling from which to make observations and draw conclusions.

As every other member of the committee has experienced, I am deluged by mail from all sectors of the economy pointing out inequitable results observed under the code and urging reform of the bankruptcy law. We must heed these requests, and you are responding responsibly by conducting this hearing.

Mr. Chairman, please allow me a short aside. It was one of my great disappointments when I chaired this subcommittee during the last Congress that we could not enact into law the technical amendments bill, despite passing it out of the Senate on three different occasions. Despite tremendous support and an urgent need, it failed to pass because certain Members in both Houses had unyielding positions on the issue of bankruptcy judge retirement.

I would like to plead with those parties, and particularly the bankruptcy judges, not to hold important bankruptcy legislation hostage to the retirement issue. You are playing games with literally the fate and fortunes of millions of Americans who are interested parties to bankruptcy suits, and it casts a black mark on everyone concerned.

I support modification of the bankruptcy judges' retirement system, but it should not be the tail wagging the dog. To assure a proper vehicle for consideration of this issue, yesterday I introduced a bill to upgrade bankruptcy judges' retirement. Chairman Rodino in the House has an identical bill. I urge the subcommittee to once and for all address the issue of nonarticle III judicial retirement, but on its own merits.

Returning to the specific subject of these hearings, I have reviewed the proposals and found most of the amendments were also the subject of discussions 3 years ago, and some were even included in the Senate version of the Bankruptcy Reform Act, then S. 2266, but later stricken at conference. Others were discussed and dropped at that time, but life the past 2 years under the code has raised the issues anew, and this time we have the experience and empirical data upon which to judge their merit.

I want to endorse particularly those changes that are being suggested to section 547—the preference section—and to chapter 13 in general. These two areas have been the subject of much abuse and misunderstanding. Experience certainly has not met the expectation we had for these provisions.

The major new proposed revision to the law of bankruptcy, and the primary topic of discussion today, is whether the law should provide for payment of debts out of anticipated future income. This is a valid issue for discussion, but there are those who will ridicule such a proposal as condoning "involuntary servitude."

My experience has been to the contrary. Most people are greatly surprised to find that a court does not consider future income when a person seeks relief in bankruptcy.

In 1980's America, it is a fact of life in credit extension and other major financial decisions that anticipated future income is a key factor to be weighed in the decision process. I see the ultimate purpose of our bankruptcy laws to relieve, through an orderly process, the honest debtor of the pressures brought on by the accumulation of a debt that reasonable people conclude would be hopeless and unjust to expect the debtor to pay, and to then return that person to society as a productive member. At the same time, we expect people to pay their debts if they can.

As I understand the basic proposal before you, it says, "An individual may be a debtor under chapter 7, only if such individual cannot pay a reasonable portion of his debts out of anticipated future income." Again, I suggest that this is the general standard most people think the bankruptcy law follows or should follow, and they are shocked to learn that a person can take advantage of the bankruptcy laws even if they are solvent and have a clear ability to repay their debt.

I hasten to add that most debtors fall into the category of honest debtors who, as a result of factors beyond their control—natural disasters, medical reversals, loss of jobs, et cetera—find themselves in a position of not being able to pay their debt.

I understand that other witnesses this morning will present statistical evidence indicating that nearly 60 percent of all individual debtors fall into this category of complete inability to repay their debts.

But this leaves 40 percent approximately who have an ability to repay their debt in some degree over an extended period of time. All kinds of options or alternatives can be thought of as to how to best and most equitably deal with this latter category.

Compassion and understanding of the needs of the debtor must be matched against the moral and legal principles encouraging repayment of debt. I would support efforts to assure that the costs of bankruptcy are not lowered more than are required to achieve the benefits which we seek.

Most comments today will deal with amendments to chapters 7 and 13 of the code. In fact, I believe no amendments to chapter 11, the reorganization chapter, are under consideration. I do not have specific suggestions in that regard but simply pass on what has come to my attention from judges, creditors, and debtors—that modest changes might also be needed to this chapter. Compared to the number of chapter 11 cases filed, there have been remarkably few confirmed plans.

The basic problem revolves around the inability of a creditors' committee to oversee a reorganization and the amount of supervision or direction a judge should give to a reorganization case.

I do not want to suggest that judges must become mired in the administrative details of a chapter 11 case, but just as clearly they should not be forced to sit idly by, as many of them interpret the present law to say, and watch the mishandling of reorganization when their supervision could mean the difference between success or failure. With more and more companies resorting to relief under chapter 11, it is even more imperative that this chapter meet the demands being placed upon it.

My final point, Mr. Chairman, is simple but elusive. It is to point out and emphasize that the best interests of debtors are not necessarily synonymous with the best interests of the mass of consumers. In fact, they are often contradictory.

Most consumers pay their debts, and they have a right to expect their fellow consumers will pay if able. It is the bill-paying consumer who picks up the cost of bad debts passed through by the creditor. To allow too easy a ride for the nondebt-paying consumer—the bankrupt—is to penalize the overwhelming number of bill-paying consumers.

Several of my constituents who are consumers have made clear to me their disgust with their fellow consumers who spend their way frivolously into debt and then take the easy out of bankruptcy.

Everybody comes out a loser in a typical bankruptcy case. The best we can strive for is to attempt to return the debtor to a position where he can again become a productive member of society unburdened by heavy debt, while being fair to the creditor's expectations and society's expectations.

I have concluded that under our present bankruptcy law the delicate balance of creditor versus debtor rights has become tilted slightly in favor of the debtor. That balance must be restored, and this bill contains the ingredients to do so.

Thank you, Mr. Chairman.

Senator DOLE. Senator Heflin, do you have questions?

Senator HEFLIN. No, thank you.

Senator DOLE. I want to thank you, Senator DeConcini, for agreeing to be the lead-off witness in setting the stage for what I believe to be very important hearings, and not only that but for your leadership in the past in this area and for your willingness to provide that in the future.

As you know, one amendment is rather controversial and will have to have strong bipartisan support.

Senator DECONCINI. I think it is there, Mr. Chairman, and I thank you.

Senator HEFLIN. I might ask one thing else, Senator DeConcini. You brought up chapter 11. It might be that some member of your staff could point out some specific suggestions on that.

Senator DECONCINI. I would be glad to do that. We have had a number of contacts on the reorganization plans. The role of the judge has been the subject of a very wide interpretation by the bankruptcy judges—wider than what I thought was in the law when we passed it. Members of staff would gladly make themselves available to the subcommittee, and we thank you for that opportunity.

Senator DOLE [chairman of the subcommittee, presiding]. Thank you, Senator DeConcini.

Senator DECONCINI. Thank you, Mr. Chairman.

Senator DOLE. Our first witness will be Mr. James Barr, executive vice president of the Credit Union National Association, Washington, D.C.

I might say for the benefit of all witnesses that we have a bill on the floor, and it may be necessary if there are rollcalls for us to leave on a temporary basis. I would also encourage witnesses to limit their statements to 5 minutes; we will place the entire statements in the record.

We hope to have some time for questions, but I note that there are about 16 witnesses and we have some time constraints. So if you can accommodate that, it will be appreciated.

STATEMENT OF JAMES C. BARR, EXECUTIVE VICE PRESIDENT, CREDIT UNION NATIONAL ASSOCIATION, WASHINGTON, D.C.

Mr. BARR. Thank you very much, Mr. Chairman.

My name is Jim Barr. I am executive vice president of the Credit Union National Association, the association which represents well over 90 percent of this Nation's 22,000 credit unions. However, I am testifying today on behalf of the National Coalition for Bankruptcy Reform.

This coalition represents virtually all segments of the Nation's credit grantors—banks, retailers, finance companies, and credit unions. The coalition was formed early this year in response to the alarming growth of bankruptcies following the passage of the Bankruptcy Act of 1978.

We recognize that this unprecedented growth in bankruptcies is due to a number of factors, not just the new code. Certainly the economy, lawyer advertising, lending practices, changing attitudes, as well as the new code have all contributed to the increase in consumer bankruptcy. But we also believe that part of the problem can be solved by amending certain provisions of the new code to

require those who can and should to repay their legitimate obligations.

In seeking these changes, we are not attempting, nor would we attempt, to do violence to the concept of providing a fresh start to those that need it.

As will be pointed out here today, the changes the coalition are seeking would not affect some 70 percent of those filing for bankruptcy. What our proposals would do is prevent that minority of debtors—some 30 percent—who have the ability to pay their debts from not honoring them.

I believe the testimony of those appearing here today with me on behalf of the national coalition will bear this out. However, before they present their detailed comments on the bankruptcy issue, I would like to briefly summarize the position of the National Coalition for Bankruptcy Reform.

This year, somewhere between 450,000 and 500,000 individuals will be relieved of all their debts under chapter 7 of the Bankruptcy Code. Upward of $6 billion of nonmortgage, nonbusiness debt will be discharged in 1981; most of this will be consumer credit. Much of this $6 billion loss cannot be avoided.

Many people who declare bankruptcy have neither the assets nor the income to pay. Bankruptcy was designed to afford protection for these debtors, even the ones who may have arrived at that condition due to unwise use of credit. But there is an emerging dark side to bankruptcy. Many debtors are legally avoiding repayment as a matter of convenience, not need. Although this is not an entirely new phenomenon, the degree of abuse is.

A recent survey conducted by Purdue University's Credit Research Center suggests that about one debtor out of three taking straight bankruptcy has the capacity to repay debts in full or in substantial part and without hardship.

As a result, the Purdue study indicates one-fourth of the anticipated $6 billion in 1981 losses, or about $1.5 billion, could have been repaid by bankrupt debtors had they chosen to do so. Put another way, the Bankruptcy Act, by allowing some consumers simply to choose not to pay their debts, is producing unnecessary income transfers from paying consumers to nonpaying consumers through increased rates. Worse, credit availability is being reduced where such costs cannot be passed on.

Landmark bankruptcy reform was achieved by the Congress in 1978. Many desirable protections were afforded consumers, but Congress did leave an imbalanced code grounded in pre-20th century economic sanctions.

Lending used to be based principally on assets. To borrow money, a debtor had to pledge assets. If the debtor did not pay, he lost his assets. Traditional consumer bankruptcy relief is predicated on that experience.

Today, however, virtually all consumer credit is extended upon a consumer's ability to repay out of future income, not through liquidation of assets. Yet, while the creditor looks to income, the Bankruptcy Code looks only to assets. Not surprisingly, virtually no assets are available for distribution to creditors in consumer cases.

Generous property exemptions with respect to the consumer's most valuable assets—homes and automobiles—leave creditors with virtually no protection upon default.

In short, the code approach contradicts the basic assumption on which credit was extended—the consumer's future income. This is the reason bankruptcy losses are as large as they are and the reason they are on an increasingly upward spiral.

It is essential that future income be taken into account in determining the nature and scope of relief to be provided debtors in economic distress. This could best be achieved, and without undue hardship to anyone, simply by limiting access to chapter 7 to only those debtors who have no demonstrable ability to pay.

Under such a test, if the debtor's petition disclosed no income above the amount reasonably necessary to support himself and his dependents, he would receive a full discharge from those debts. Notwithstanding this requirement, a majority of those taking straight bankruptcy today would still qualify for 100 percent relief.

On the other hand, those debtors with sufficient disposable income to pay their debt would be ineligible for chapter 7 relief. However, they could still obtain court protection if needed in a chapter 13 proceeding by filing a proposed repayment plan based on their disposable income.

Finally, those remaining debtors who could pay but do not truly need court protection and are only using chapter 7 as a legal device to avoid repayment would be unlikely to appear in a bankruptcy proceeding at all.

A natural consequence of a threshold eligibility test based on income is that those debtors who can pay but need court supervision will file proposed repayment plans under chapter 13. Such repayment plans work quite well in many jurisdictions, poorly in others, and not at all in quite a few. Part of the blame lies with the code, part with the courts; legislative improvement could cure most of the problem.

The code must be amended to tailor payment plans to the debtor's ability to pay, both with respect to duration and amount. Thus, a debtor should be required to devote that portion of his income to the plan which is not necessary for the support of the debtor and his family.

Likewise, since maturities of many consumer debts today often exceed 36 months, it makes sense to expand the time during which the debtor may make repayment. Longer repayment periods will also give the debtor more time in which to pay unsecured debt. A recent study shows that only 28 percent of unsecured debt is repaid during a typical 36-month plan whereas 70 percent would be repaid in a 4-year plan and 100 percent in less than 60 months.

Much—about one-fourth—of the anticipated 1981 bankruptcy loss of $6 billion could be avoided by: One, making chapter 7 relief available only to those with no demonstrable ability to pay out of future income; two, incorporating a "disposable income" standard in chapter 13 as a measure of repayment; and, three, permitting chapter 13 repayment plans to extend up to 5 years to accommodate today's larger loans and longer maturities and to permit repayment of unsecured debt.

Thank you very much, Mr. Chairman, for giving us an opportunity to testify here this morning. I will be glad to respond to any questions that you or Senator Heflin may have.

Senator DOLE. Senator Heflin?

Senator HEFLIN. I have got a lot of different inquiries on the concept. The concept appeals to me in the idea that a person who can pay his debt ought to pay it. My bankruptcy practice in the law is about 15 years out of date, having served on the court and then in the Senate. As I remember, under the wage earner's plan, it started out that you had a limitation. There was a provision that if the wage earner plan caused undue hardship, then you could be transferred and you could go into a chapter 7 straight bankruptcy.

I have not really seen any definitive legislation. I suppose that is perhaps our responsibility to draw up. There are a lot of questions about these things that come up. It would almost seem that basically if you would deal with a wage earner chapter 13 plan you would have constant problems that could come up, which probably would mean you would have to have a substantial increase in personnel in bankruptcy courts. That is not a reason against the concept.

Let us say a person is able to place his future assets and his income on that. He gets a divorce, and he is required to pay alimony and child support. What happens? I am raising a hypothetical situation. Would he then have to go back and get a new plan that would work—a new evaluation of whether his future assets were such that he could continue to pay off? Would it be basically the idea you have in mind—the concept that as circumstances may change, the end result is whether he does or does not stay under a wage earner chapter 13 or then has to go back to a chapter 7? Would that be involved?

Mr. BARR. Absolutely, Senator Heflin. It is what we refer to as the safety net concept. If someone did file under chapter 13, if that individual's circumstances were to change, he would have the opportunity at that point in time file under chapter 7.

Senator HEFLIN. These safety nets are beginning to have a lot of missing strings and gaping holes. Would a great deal of this be left largely to the discretion of the bankruptcy officials?

Mr. BARR. It would be left up to the court; yes.

Senator HEFLIN. That would be dangerous. Some of them would be extremely liberal—the bleeding hearts—as opposed to the tougher ones.

Mr. BARR. You have that situation today. In some jurisdictions 70 percent of the petitions filed for bankruptcy are under chapter 13 and in other jurisdictions 70 percent are under chapter 7. It depends basically, I believe, on how the court handles the cases that come before it. There is a great deal of discretion and latitude left to the individual courts.

Senator HEFLIN. One of the big problems we have got today with the big increase in bankruptcy is lawyer advertising.

Mr. BARR. There is no question about it.

Senator HEFLIN. From the viewpoint of Congress, is there any immediate action we can take that would reduce that?

Mr. BARR. You mean reduce the lawyer advertising?

Senator HEFLIN. That perhaps. You see ads in the papers which say, "If you have got debts," and so on. They have got truth-in-

lending laws; could you have truth-in-lawyer-advertising on bankruptcy?

Mr. BARR. Perhaps that is something we could consider.

I do think some of the ads tend to be misleading where they indicate to consumers who are in some financial distress that one can come in and liquidate all one's debts and start over just as though nothing had happened. We know basically that is not the way it works.

People who file for bankruptcy do find when they go back into the consumer credit market that they have difficulty getting credit from most segments of the credit-granting community. This is not to say that there are not people out there who will continue to extend credit to people, but when you talk to most creditors—when you talk to the members who are participating in the coalition—I think you find that almost universally, on a bankruptcy case under chapter 7, they view that particular individual with great alarm when they come back to apply for credit a second time. It definitely makes credit more difficult to obtain.

Senator HEFLIN. If you were to go into this new concept, would it require a reevaluation of exemptions?

Mr. BARR. You mean the exemptions in the code now, Senator?

Senator HEFLIN. Basically those exemptions are directed toward chapter 7—most of them.

Mr. BARR. Yes.

Senator HEFLIN. The exemptions if you go toward more of a 13—would they be subject to being viewed differently than what you would have under 7?

Mr. BARR. Prior to the passage of the Bankruptcy Reform Act of 1978, the exemptions were left to the States. When the law was changed in 1978, a series of Federal exemptions was listed in the code, and the States were given the opportunity to override that Federal exemption list if they chose to do so. I think at the present time some 31 or 32 States have already chosen to override the Federal exemption scheme.

Speaking for the coalition, our preference would be to see the code amended once again to leave those exemptions with the States as opposed to mandating them in the Federal code.

Senator HEFLIN. To leave it with what?

Mr. BARR. With the individual States, Senator, since better than half of the States have already chosen to override the Federal exemption levels.

Senator HEFLIN. I understand that is pending.

Are there any peculiarities under this new concept that will bring about differences as to other aspects of the laws including exemptions?

Mr. BARR. Not that I am aware of, Senator.

Senator HEFLIN. If a person has an excellent ability to pay into the future and he has an exemption of real estate allowed him, will he pay the exemption, or will he not pay the exemption? If you had an exemption for real estate of a certain amount, would you be entitled to that anyway?

Mr. BARR. Under the Federal code as it now stands, there is an exemption for debts secured by real property. That exemption can be used to exempt other assets that the debtor has if there is, in

fact, no real property. The debtor uses the real property exemption and can protect any other asset in the estate.

The debtor is afforded another protection because he can reaffirm the debt if he chooses to do so if it is a debt secured by real property and all real property loans are obviously so secured so that he can choose to pay those debts as opposed to discharging it in a bankruptcy petition. He keeps the asset, he pays on it, and other debts are discharged or liquidated in the proceeding.

Senator HEFLIN. I suppose what I am driving at generally is that if this concept takes place, what are the problems we can anticipate, or what legislation should be drafted?

We have got the history of the relationship between the two and the fact that if you went into a wage-earner plan you could then go toward a straight bankruptcy. But it may well be that these things just have to be left to judicial construction, case by case, in the development of a common law. I am just trying to anticipate if there are some real problems we would have to look to if it is decided to go into this new concept.

Mr. BARR. I think a major concern I would have, if I were in a position to draft legislation in this area, would be to be sure that what we did would not overburden the court system.

As we worked with the coalition, we had consultants from the court system advising us, and at least we in the credit union movement participating in the coalition were satisfied that the amendments we would suggest to the Congress would not overburden the court system. That would be my No. 1 concern.

Perhaps even overriding that concern would be to make sure that laws are not passed that would prevent the person who is truly bankrupt from getting relief—the fresh-start concept. We believe in that concept. We are also satisfied that the amendments that we are offering today would not do any harm to the fresh-start concept.

I think those would be my main concerns, Senator Heflin.

Senator HEFLIN. One of the most frustrating things that any lawyer or any judge ever confronts is in the domestic relations field between a husband and wife, where there are children. Every time you give a decree that the husband will deliver the child back to the mother at 5 o'clock on Sunday afternoon, after he has had the child for the weekend, and he gets there at 5:10, the mother is filing the petition to hold him in contempt of court or to do something—phoning the lawyer as to why the man did not do it. There are a multitude of problems there.

Somehow or another, I would like to see that every time a person changes his mind or a person is 1 day late or something else, it does not cause the burden of the constant problem confronting domestic relations divisions of courts. You just have these constant problems about the custody of children and that sort of thing.

Whether that is comparable to this or not, I do not know, but I can foresee that every time the man has to go to the doctor causing an increase in his costs, he has got to come back and petition because of a doctor bill, saying, "I've got to have an extension of time," or, "I've got to have a lower percentage of payment." Then there are the other times when he might be somehow late in the credit plan, and there will be petitions coming into the court. You

have got problems of this sort that we somehow need to minimize if we possibly can.

Mr. BARR. Yes, sir, we certainly share your concerns.

I think, basically, what will happen if the law is changed in the various bankruptcy jurisdictions is that the attorneys who practice in that jurisdiction will soon become aware of how the court works—the thinking of the judge, and so forth. I think that would tend to minimize much of what you are talking about.

The creditor is simply not going to spend a lot of money pursuing frivolous cases before the court. I think there would be a built-in self-discipline. But I can certainly understand your concern, Senator.

Senator HEFLIN. Thank you.

Senator DOLE. Mr. Barr, we may be submitting a number of questions in writing, if that is satisfactory.

Mr. BARR. Yes, sir.

Once again, we certainly appreciate this opportunity to testify, Senator.

Senator DOLE. Our next witness is Dr. Robert W. Johnson, director of Krannert Graduate School of Management, Purdue University.

STATEMENT OF ROBERT W. JOHNSON, DIRECTOR, KRANNERT GRADUATE SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, WEST LAFAYETTE, IND., ACCOMPANIED BY RICHARD L. PETERSON, ASSOCIATE DIRECTOR, CREDIT RESEARCH CENTER

Mr. JOHNSON. Mr. Chairman and members of the committee, we have filed a written report, and I will try to summarize in a 5-minute period the essence of that report.

The Credit Research Center is a nonprofit organization established in 1974 as part of Purdue University.

I am appearing here at the invitation of Senator Dole and am accompanied by Dr. Richard L. Peterson who is the associate director of the Credit Research Center.

These are my personal views and do not necessarily reflect the views of Purdue University.

I would emphasize that the research design, the questionnaire, and the petition data sheet were prepared independently of the credit industry in cooperation with Arthur D. Little and Opinion Research, the survey organization.

DATA BASE

Our data base comes from a randomly selected sample of chapter 7 respondents in the courts of 47 judges in 20 judicial districts in 10 States.

As part of our sampling procedure, we insisted that there be at least two judicial districts in each State. Therefore our sample is from the large States which tend to be representative of the Nation as a whole. We have five States with high exemptions and five States with low exemptions, those States being selected by Mr. Blair Shick of A. D. Little.

We considered a couple filing jointly as one respondent, a case, or a filing. We had successful interviews with 54 percent of the

people we attempted to interview, giving us 1,199 interviews. We also gathered data from the petitions of the other 1,050 nonrespondents in order to test the validity of our sampling procedure.

ESTIMATES OF AVAILABLE INCOME

Our first step was to estimate the available income—the income that would be available to these respondents to pay off a portion of their nonmortgaged debt, since that income was the basis for granting credit in the first place. In every instance, we tried to be conservative—that is to say, to understate the income available to repay affordable debt.

We asked the respondents to tell us their current income. We calculated the taxes and the social security payments, deducted those from that income, and added back in any other nontaxable income such as unemployment insurance income.

We next estimated their basic living costs, giving recognition to the size of the family. We obtained from the respondents their actual housing costs—mortgage payments, rental payments, payments for utilities, payments for mortgage insurance, and payments for property taxes. To that we added basic nonhousing costs based on estimates from the Bureau of the Census, which we adjusted upward for changes in the Consumer Price Index and for regional differences in the cost of living.

Our two estimates—one for basic living expense and the other for basic living expense plus a 20-percent cushion—bracketed the average expenses for four-person, low-income families reported by the Bureau of Labor Statistics.

We deducted the basic living costs from the calculated income after taxes to obtain the income available to repay nonmortgage debt. I would emphase "nonmortgage debt" since in the calculation of our basic living expenses we included continuing payments on mortgage debts if they existed.

I would emphasize further that we are not predicting that the income of these consumers will continue, as they reported at the time of the interview, for the next 5 years. We are simply saying that if income continues at this level for a period of 5 years, 3 years, or 4 years, they will have the following ability to repay the debt that they show on their petition at the time of the filing. Therefore we did not adjust upward for the changes that might be anticipated in income because of the general inflation movement.

Further, we did not adjust upward for the fact that 50 percent of our respondents told us that they definitely expected or probably expected their income to be higher at the end of the year than at the time of the interview.

The model that Dr. Peterson developed to make these calculations can readily be made available to the Administrative Office of the U.S. Courts and could probably be programed in a microcomputer in the various courts and made available to the judges to make calculations for the basic living expenses and the income available to these consumers to repay their affordable debts.

EXTENT OF AFFORDABLE DEBTS

We took the income that was available after basic living expenses and related that to the nonmortgage debts of these consumers. We have two points to make.

First, there is a hard core of consumers whose basic living expenses are so high in relation to their income that they have no possibility of repaying their debts. This is probably 50 to 60 percent of the cases filed.

These are the people for whom bankruptcy is the only way out. These people need a fresh start, and the 50- to 60-percent hard-core bankrupts are very insensitive to any changes in the various calculations that I have cited to you.

On the other hand, we did find that there was a significant number of people who filed for chapter 7 who could have repaid some portion of their debts. For example, 29 percent could have repaid all of their nonmortgage debts in full in a 60-month period. Almost two-fifths of the people filing for chapter 7 could have paid 50 percent or more of their nonmortgage debts in a period of 60 months.

Further, we attempted to estimate what the affordable debt would mean in terms of aggregate levels of affordable debts in the U.S. economy. We estimated that there would be about 315,000 filings annually. That is filings; that is not the number of consumers involved in personal bankruptcies.

In the first half of 1981, there were 228,000 persons involved in personal bankruptcies. That works out to an estimate of about 457,000 persons involved in the bankruptcy process in 1981, but we have reduced that number to an estimated 315,000 filings, so that we keep the data on the same basis on which we gathered the data—namely, the cases or the filings.

We estimated for each individual consumer the amount of debt that he, she, or the family had; the amount of income available to repay their nonmortgage debts; and we estimated that there would be available about $1.9 billion annually, assuming an annual rate of 315,000 filings and a 60-month repayment period, that might be recoverable by a change in the statute.

We assume, in accordance with the comments made by Senator Heflin, that there would be people dropping out of the system. One would not be able to recover the full amount of the affordable debts.

By a process which is detailed in my written statement, we reduced the $1.9 billion to a recoverable amount of $1.6 billion annually paid out over a 60-month period.

We note further in the written testimony that increasing the payout period significantly affects the amount that is recoverable, stretching the amount recoverable from $1.1 billion on a 36-month payout to $1.6 billion on a 60-month payout.

Let me conclude by talking about the economic impact of the potential change.

UNPAID DEBT AS A WEALTH TRANSFER

I think it is important to recognize that we are not talking about an issue that is industry versus consumer. In the long run, bank-

ruptcy costs must ultimately be covered as a cost of doing business by all creditors. It is a cost of doing business just like labor costs, just like rental costs, and the cost of funds.

Therefore the creditors, to cover these bankruptcy costs, ultimately must pass them on to consumers who use credit as a higher annual percentage rate, in more restricted terms, such as requiring second mortgage credit or other secured forms of credit, or lower availability of credit.

Thus, what we are talking about is a wealth transfer from those who pay their debts to those who have chosen not to pay their affordable debts. The important thing then is that this is a conflict between those who are paying their debts and those who have chosen not to pay their debts.

People who are most affected will be those who could pay 100 percent or more of their nonmortgage debts. Again, using calculations for each individual respondent, we find that the mean income of that group who could repay all of their nonmortgage debts over 60 months is over $17,000. Their mean nonmortgage debt is $10,800. Those are the people who would be affected primarily by the contemplated change in the statute.

I have been quoted fairly widely as saying that consumers are not abusing the bankruptcy system. Let me place that back into the context in which I originally said that. My point is that these consumers who could repay their debts but have chosen not to do so are exercising legal rights provided by the statute in the same way that I am exercising my legal rights when I take as a tax-deductible expense the interest on my residential mortgage.

The issue before this committee is whether or not you wish to continue this wealth transfer from those who pay their bills to those who have chosen not to do so.

Thank you very much for the opportunity to appear.

Senator HEFLIN [acting chairman]. You are not advocating doing away with that deduction on interest, are you? [Laughter.]

Senator Dole has some questions he would like asked.

Dr. Johnson, as I understand your testimony, the estimation of future income used in your calculation is based upon an analysis of the gross incomes of the debtors studied at the time of the filing of the bankruptcy. Did your interviewers examine the question of what the expected income level of the debtor after bankruptcy would be in order to assess in some way the security of the income base of that debtor?

Mr. JOHNSON. We found—perhaps to us anyway—an unexpected high level of our respondents who were employed. Among the petitioners, 78 percent of the cases had at least one person employed full time. So this was not a situation where there were large numbers—50 percent or whatever—that we might have expected of people who had no jobs and no source of income.

Further, we asked the consumers, "Do you expect your income to be higher, or lower, or about the same by the end of the year?" Fifty percent of the consumers said that it would definitely be higher or probably higher by the end of the year.

Senator HEFLIN. The second question is: Are you reasonably confident that the information gathered through your examination of petitioners and personal interviews accurately reflects the

trends that would be found nationwide if a similar analysis was done in other areas of the country not covered by your study?

Mr. JOHNSON. We feel quite confident about an interview size of 1,200, given the States in which we selected those interviews. They were large States, they were widely diversified geographically, and we had an additional 1,050 petitions from the nonrespondents so that we could check the accuracy of our sampling procedure.

We are very pleased with the work that A. D. Little and Opinion Research did in randomizing the sampling procedure in the courts of 47 judges. We have no reason to believe that expending more money and going into more States would significantly change our results.

Senator HEFLIN. Do the results of your study indicate that debtors in the lower income groups would be able to file for chapter 7 relief even if there were a future earnings requirement?

Mr. JOHNSON. The data indicate very clearly that those consumers in the low-income brackets who are now what I would refer to as the hard core of bankrupts would be completely unaffected by any change in these statutes.

The average income of the people who could not afford to pay anything on their debts is $5,650. The average pretax income of those who could afford to pay 0 to 25 percent was $10,800. Those people would be left alone and would not be affected in any way by any change in the statute.

Senator HEFLIN. Are you familiar with other studies of the future earning capacities of chapter 7 debtors which may have been done? If so, would you summarize for us the results of those studies and give us your opinion of their reliability?

Mr. JOHNSON. There was a study done quite some years ago at Michigan State University by a doctoral student that I supervised: Robert Dolphin. He made a somewhat similar study of future income in relation to debts. He reached very much the same conclusion at that time. This was probably in the 1960's.

However, he based his basic living expense on his own expenses as a lowly paid doctoral student at Michigan State University, and I think he was well below the poverty level. Consequently, while he found a larger proportion, as I recall, of people with ability to repay, I would want to adjust that for the penurious standing of living that he himself lived with.

Senator HEFLIN. Several of the witnesses today in prepared statements have requested an opportunity to analyze and evaluate your survey. Would you be in a position to make available to these witnesses and other interested individuals who are concerned with this proposal sufficient information such as to your methodology and other information necessary to make proper analysis of the survey for the benefit of the subcommittee?

Mr. JOHNSON. We would be very happy to do so.

Our problem has been that we received the tape toward the end of August, and we have been working quite frantically simply to get the tape running and the data off the tape for the benefit of this subcommittee.

I received just before coming here the chapter by Blair Shick on the sampling methodology, and that will be made available at any time at your request.

Dr. Peterson is in the process of completing his chapter on the calculations involved in estimating available income, and I would think within a week or 10 days we could make that available to the members of this subcommittee or anybody else who so desires it.

Senator HEFLIN. Thank you, Dr. Johnson.

Mr. JOHNSON. Thank you, Senator.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF ROBERT W. JOHNSON

Mr. Chairman and Members of the Committee

My name is Robert W. Johnson, Director of the Credit Research Center, Purdue University. The Credit Research Center (CRC) is a nonprofit research organization that was established in 1974 as a part of Purdue University. Over the first five years of our existence, about half of our financial support came from various government agencies and about half from unrestricted grants from a broad cross-section of the credit industry. More recently, we have come to rely more heavily on unrestricted grants from a diverse industry group.

I am appearing at your invitation to present our research findings relevant to your consideration of possible modifications to the Bankruptcy Act of 1978. These are my personal views, and I am not speaking on behalf of the Credit Research Center or Purdue University. I am accompanied by Dr. Richard L. Peterson, Associate Director, of CRC. He has had a major role in preparing the data to be provided to this Committee today.

BACKGROUND OF RESEARCH PROJECT

The origin of our research lies in the rapid escalation of the number of consumer bankruptcies over the past year and a half. Credit counsellors, legislators, consumer groups, and the credit industry have expressed concerns about this sharp increase in consumer bankruptcies.

In the latter part of 1980, the Credit Research Center was approached by a group now termed the National Coalition for Bankruptcy Reform to undertake a study of consumer bankruptcies. We accepted the task with the approval of our Governing Board and with the same agreement concerning our findings that we have made when doing research funded by the Federal Reserve Board, the National Science Foundation, the Federal Trade Commission, the Western Bank Card Association, and the Bank of America. That agreement specifies that we are completely free to publish the results whether or not they are "palatable" to the

funding organization. Further, we stipulated that the design of the study was to be our responsibility in cooperation with Arthur D. Little, Inc. and its subsidiary, Opinion Research Corporation.

Dr. Richard L. Peterson, Dr. A. Charlene Sullivan, and I drafted the debtor questionnaire and the form for collection of data from the bankruptcy petitions. We then reviewed and revised portions of these instruments with Dr. Edwin B. Cox and Blair C. Shick of Arthur D. Little, Inc. and Sandra M. Spies of Opinion Research Corporation. Subsequently, the questionnaire was field tested by Opinion Research. The final questionnaire was then used in the field during the late spring and summer of 1981. Until this point in time, to the best of my knowledge, nobody in the credit industry saw the questionnaire. In fairness, nobody from the industry asked to see a copy. My estimate is that about five-sixths of the funds raised by the National Coalition were absorbed by the interviews and collation of the data gathered, with the remaining one-sixth allocated to CRC for the design of the research and the analysis of the data.

OBJECTIVES OF RESEARCH

There were three main objectives of the research:

(1) To measure the amount of debts that Chapter 7 debtors could have repaid from future income after meeting their basic living expenses.

(2) To measure the effects, if any, of different exemption levels among the states on the characteristics of Chapter 7 debtors.

(3) To examine the process by which debtors chose Chapter 7 bankruptcy, tracing the decision process from their evaluation of the causes to their view of the consequences of bankruptcy.

This report summarizes our findings with respect to only the first of these objectives.

THE DATA BASE

We relied on Blair Shick of A. D. Little, Inc. to identify five states with high exemption levels and five with low exemption levels.

At the time of the interviews, the low-exemption states were Georgia, Illinois, Louisiana, Ohio, and Virginia; the high-exemption states were California, New York, Pennsylvania, Texas and Wisconsin. Debtors filing for Chapter 7 were interviewed from the courts of 47 judges in 20 judicial districts, two judicial districts in each of the ten states surveyed.

Debtors were randomly selected by interviewers from Opinion Research Corporation. The sample was drawn from Chapter 7 petitions. A couple filing jointly was considered as one respondent, although information on income, employment, and demographic characteristics were collected for both. Interviews were obtained with 54 percent of the debtors that interviewers selected. Successful interviews were completed with 1,199 respondents. Key data were also obtained from debtors' bankruptcy petitions and, in many cases, copies of debtors' credit reports were obtained with the debtors' permission. For debtors that refused interviews, the same types of key data were obtained from their bankruptcy petitions. These data were used to determine if there were any significant differences between respondents and nonrespondents.

CALCULATION OF INCOME AVAILABLE TO REPAY NON-MORTGAGE DEBTS

Our first task was to estimate the future income that debtors could reasonably be expected to have available to apply to their existing non-mortgage debts. When faced with judgmental decisions in preparing these estimates, we always tried to be conservative, in the sense that the decision made would tend to understate the income available to repay non-mortgage debts. For example, we employed the standard deduction, even though debtors might have been able to reduce taxes by itemizing their deductions.

First, we obtained from the questionnaire each petitioner's estimate of current income before taxes. Taking data provided on the numbers of dependents, we then calculated the federal income tax and social security tax and subtracted these amounts, as well as alimony payments, from each

debtor's pre-tax income. We added any non-taxable income such as unemployment benefits reported on the questionnaire. These calculations produced an "adjusted family money income" for each of the respondents.

Second, we calculated the outlaws necessary to maintain the person or family filing for bankruptcy in the same housing status held at the time of filing and to meet basic living expenses for food, clothing, and other non-housing expenses. Housing expenses included rent or mortgage payments, utilities, and any property taxes and property insurance payments. The non-housing living expenses were based on estimates of basic living expenses prepared by the Bureau of Census, adjusted by us for number of dependents, upward movements in the Consumer Price Index, and regional differences in the cost of living.

To measure the sensitivity of our subsequent calculations to estimated non-housing living expenses, we incorporated a 20 percent "cushion" above non-housing living expenses for comparison with estimates without the cushion. Our two estimates of total living expenses, with and without the 20 percent cushion for a family of four, bracketed the average expenses for low-income families prepared by the Bureau of Labor Statistics. Therefore, we believe that our estimates of basic living expenses are fair and reasonable, especially since we accept as necessary whatever housing expenses were reported by the debtors.

In individual cases we also adjusted the basic living expenses upward by any extraordinary expenses, such as child care, child support, and medical expenses. These calculations produced an "adjusted basic living expense" for each of the petitioners.

Subtraction of adjusted basic living expenses from the adjusted family money income produced the income available to apply to non-mortgage debts. Note that we are concerned only with non-mortgage debts, since we have already allowed for a continuation of any residential mortgage payments as part of basic living expenses.

ABILITY OF CHAPTER 7 DEBTORS TO REPAY NON-MORTGAGE DEBTS

Our first calculation of debtors' ability to repay their non-mortgage debts was based on a demanding standard. We asked, "How long would it take Chapter 7 debtors to repay their existing non-mortgage debts in full assuming that their income remains at its current level over the repayment period?" The results of this analysis, based on separate calculations for each respondent, are shown in Exhibit 1. Even with this demanding standard, it is apparent that 29 percent of the respondents could have repaid their non-mortgage debts in full within a period of 60 months. With a 20 percent cushion on basic non-housing expenses, 23 percent could have repaid their non-mortgage debts in full over the same period.

Our next set of calculations were based on the more reasonable assumptions that debtors might repay some portion of their debts over periods ranging from 36 months to 60 months. Tabulations of these calculations for each respondent are shown in Exhibits 2 and 3. Two major points are worth noting. First, somewhat over half of the Chapter 7 debtors had insufficient income after meeting basic living expenses to make any payments on their non-mortgage debts. Clearly, these are debtors who need the "fresh start" envisioned by the draftors of the Bankruptcy Act. Second, significant numbers of debtors could have repaid 50 percent or more of their non-housing debts. As illustration, Exhibit 3 shows that almost two-fifths of Chapter 7 debtors could have repaid half or more of their non-mortgage debts over a period of 60 months. With an added 20 percent cushion over non-housing expenses, 36 percent could have repaid half or more of their non-mortgage debts over the same period. In the discussion that follows let us refer to those debts that could reasonably be repaid out of anticipated future income as "affordable debts."

Finally, we turned to estimates of the aggregate dollar amounts nationally represented by affordable debts. To make these calculations

we made certain basic assumptions:

(1) The interview sample is representative of the ability of the population of Chapter 7 debtors to repay debts. Our preliminary analysis of the petition data from non-respondents does not provide evidence to refute this assumption, as average incomes of the two samples are practically identical.

(2) There will be 315,000 Chapter 7 filings in 1981 (about the rate during the first half of the year), and that rate will continue at this level in the future. Obviously, if the numbers continue to rise, aggregate affordable debts will also rise.

(3) Those consumers who could reasonably pay 75 percent to 100 percent of their non-mortgage debts will pay all of whatever they could afford to repay. Consumers who could pay 25 percent to 75 percent of their non-mortgage debts will pay half of whatever they could afford to repay. No payments will be made by any other Chapter 7 debtors.

The application of these "recovery factors" to our sample is illustrated in Exhibit 4. Note that, even though the earlier calculations indicate that consumers able to repay 50 percent to 75 percent could repay an average of $19,600 on their non-mortgage debts, we assume that actual recoveries from this group might average $9,800.

As a second step, we summed the amounts of affordable debts recoverable under our assumptions. Thus we calculated a recovery of $11,900 from each of 310 debtors; $16,400 from each of 44 debtors, and so on. The sum of the affordable debts assumed to be recoverable from these 1,070 Chapter 7 debtors was $5,281,347.

The final step was to extrapolate from our sample to the population of Chapter 7 debtors. Details of these calculations are shown in Exhibit 5. We conclude that nationally about $1.6 billion of affordable debts might be recoverable under our assumptions. The total amount of affordable debts from Exhibit 4 is $1.9 billion.

Aggregate amounts of affordable debts recoverable under different

payment schedules and with and without the allowance of a 20 percent cushion above non-housing expenses are displayed in Exhibit 6. Within a wide range of assumptions, it is clear that very large dollar amounts of affordable debts not being repaid under the current rules of eligibility for Chapter 7 might be recoverable were standards for admission to Chapter 7 imposed.

EFFECTS UPON CONSUMERS OF ADMISSION STANDARDS FOR CHAPTER 7 DEBTORS

These data concerning the levels of affordable debts and other data from the Credit Research Center Bankruptcy Study permit an evaluation of the effects upon consumers of an admission standard for Chapter 7 debtors based upon the applicant's ability to pay a reasonable portion of his or her debts out of anticipated future income.

As a starting point in the analysis, it is important to understand the source of the $1.6 billion developed in the previous discussion. This is not a wealth transfer from the credit industry to Chapter 7 debtors. Bankruptcy losses are a cost of doing business, just as are the cost of funds and general operating costs of extending credit and collecting monthly payments. All of these costs must be covered by income. As costs rise in a competitive market, creditors must either increase rates of charge, restrict credit availability to better quality credit risks, or impose more onerous credit requirements, perhaps by requiring additional collateral on credit extensions. Thus, the recoverable affordable debts not paid by Chapter 7 debtors are paid for by other consumers who do pay their debts. Thus, bankruptcy costs ultimately are paid by a transfer of wealth from consumers who do pay their debts to those who do not pay.

Conversely, if establishing the admission standards being considered by this Committee for Chapter 7 debtors leads to a recovery of affordable debts, competition will force creditors to lower rates of charge, increase credit availability, and impose less onerous terms. Thus, the ultimate

45(7)

beneficiaries of the changed policy will be those consumers who do pay their debts. The issue before this Committee ultimately is not a conflict of credit industry v. consumers, but of non-paying consumers v. paying consumers.

Clearly, an issue of social justice is involved. We must ask, "What are the characteristics of consumers most likely to be affected by setting admission standards for Chapter 7?" Let us explore that issue.

First, it is worthwhile noting that most of the petitioners for Chapter 7 were employed. Among the males, 72 percent reported full-time employment and 41 percent of the females reported full-time employment. If each filing is considered, whether joint or single, 78.6 percent had at least one person employed full-time. We also asked respondents:

> By December of this year, how likely is it that your total monthly income from all sources will be higher or lower than it was last month? Would you say that it will definitely be higher, probably be higher, probably be lower, definitely be lower, or will it be about the same?

Response rates to this question are shown below:

Definitely higher	24%
Probably higher	26
About the same	35
Probably lower	6
Definitely lower	4
Don't know/no response	6
	100%

(Details do not add to totals because of rounding)

In summary, almost four-fifths of the petitioners had at least one person fully employed at the time of filing, and half of the petitioners expected to have higher incomes by year-end than reported at the time of the interview.

Second, what income groups would be affected by a standard for admission to Chapter 7? The two groups who would be most affected by the proposals before this Committee are those who could afford to repay

100 percent or more of their non-mortgage debts and 75 percent to 100 percent of their non-mortgage debts. The mean annual pre-tax income of these two groups were $17,058 and $15,335, respectively. In contrast, the mean incomes of the two groups that would essentially be unaffected by a standard of admission were $10,802 and $5,650. In other words, the probability of being impacted by setting an admission standard to Chapter 7 decreases with the petitioner's income.

CONCLUSION

This analysis is not meant to imply that consumers are "abusing" the bankruptcy system in the sense that they are doing something that is illegal by filing for Chapter 7 when they could repay significant proportions of their non-mortgage debts out of anticipated future income. Instead, our analysis in this part of the study is directed at the issue raised by Chairman Dole. Specifically, what would be the effect of (1) establishing qualifications for admission to Chapter 7 proceedings; and (2) increasing the time limit on Chapter 13 plans from 36 months to 60 months? The data developed from our study permit the following conclusions:

1. An admission standard based upon the debtor's ability to pay a reasonable portion of debts out of anticipated future income offers the potential for an annual recovery of about $1.6 billion. Presently, this amount represents an annual wealth transfer from paying to non-paying consumer-debtors. The proposed change would not affect the half or more of debtors filing for Chapter 7 whose incomes are insufficient to make payments on their non-mortgage debts and meet basic living expenses. Thus, the proposed admission standard would not affect low-income consumers, except in rare cases. Most of the impact of the change would fall on consumers with incomes above $15,000.

2. The proportions and amounts of non-mortgage debts recoverable increase significantly as the repayment period is increased. For example, the estimated annual, recoverable affordable non-mortgage debts grow from $1.1 billion to $1.6 billion (an increase of 40 percent)

as the repayment period is shifted from 36 months to 60 months. This represents a $500 million difference in the annual wealth transfers identified above.

EXHIBIT 1

PERIOD OF TIME REQUIRED TO REPAY NON-MORTGAGE DEBTS IN FULL FROM AVAILABLE INCOME[a]

(PERCENTAGE OF DEBTORS)

	Basic Living Expenses			Basic Living Expenses Plus 20 Percent of Non-Housing Expenses		
Non-Mortgage Debt Repayable in	N[b]	Percent	Cumulative Percentage	N	Percent	Cumulative Percentage
0-12 mos.	47	4.4	4.4	32	3.0	3.0
13 - 24 mos.	96	9.0	13.4	79	7.4	10.4
25 - 36 mos.	77	7.2	20.5	51	4.8	15.1
37 - 48 mos.	61	5.7	26.2	51	4.8	19.9
49 - 60 mos.	32	3.0	29.2	32	3.0	22.9
More than 60 mos.	758	70.8	100.0	826	77.1	100.0
Totals	1,071	100.0		1,071	100.0	

[a]Available income equals reported before-tax income, minus alimony, minus social security taxes, minus Federal income taxes, minus reported housing expenses (mortgage or rental payments, fuel and utilities, insurance, and property taxes), minus minimum income needs specified by federal standards for nonhousing expenditures, minus other required monthly expenditures (child care, excess child support and excess medical expenses).

[b]Cases were excluded if it were impossible to calculate a consumer's ability to repay debt because critical data on debt, dependents, income or other items were missing. There were 128 such cases comprising 10.7 percent of the total sample of 1,199.

Note: Details may not add to totals because of rounding

SOURCE: Credit Research Center Bankruptcy Study

45(10)

EXHIBIT 2

PERCENTAGES OF NON-MORTGAGE DEBTS[a] THAT COULD BE PREPAID IN 36 MONTHS FROM AVAILABLE INCOME

(PERCENTAGE OF DEBTORS)

Percentage of Non-Mortgage Debt Repaid	Basic Living Expenses			Basic Living Expenses Plus 20 Percent of Non-Housing Expenses		
	N	Percent	Percentage	N	Percent	Cumulative Percentage
100% or more	217	20.3	20.3	159	14.9	14.9
75% to 99.9%	61	5.7	26.0	51	4.8	19.6
50% to 74.9%	57	5.3	31.3	55	5.1	24.8
25% to 49.9%	80	7.5	38.8	77	7.2	32.0
0% to 24.9%	97	9.1	47.9	87	8.1	40.1
None	558	52.1	100.0	641	59.9	100.0
Totals	1,070	100.0		1,070	100.0	

[a]Non-mortgage debt excludes mortgage and business debts.

Note: Details may not add to totals because of rounding.

SOURCE: Credit Research Center Bankruptcy Study

45(11)

EXHIBIT 3

PERCENTAGES OF NON-MORTGAGE DEBTS[a] THAT COULD BE REPAID IN 60 MONTHS FROM AVAILABLE INCOME

(PERCENTAGE OF DEBTORS)

	Basic Living Expenses			Basic Living Expenses Plus 20 Percent of Non-Housing Expenses		
Percentage of Non-Mortgage Debt Repaid	N	Percent	Cumulative Percentage	N	Percent	Cumulative Percentage
100% or more	310	29.0	29.0	242	22.6	22.6
75% to 99.9%	44	4.1	33.1	38	3.6	26.2
50% to 74.9%	46	4.3	37.4	46	4.3	30.5
25% to 49.9%	53	5.0	42.3	57	5.3	35.8
0% to 25.9%	59	5.5	47.9	46	4.3	40.1
None	558	52.1	100.0	641	59.9	100.0
Totals	1,070	100.0		1,070	100.0	

[a]Non-mortgage debt excludes mortgage and business debts.

Note: Details may not add to totals because of rounding.

Source: Credit Research Center Bankruptcy Study.

EXHIBIT 4

SAMPLE CALCULATION--60 MONTHS

PAYMENT SCHEDULE--STEP 1

(Dollar Amounts in Thousands)

Percentage of Non-Mortgage Debt Repaid	N	Avg. Non-Mtge. Debt	Avg. Repayable Debt	Recovery Factor	Avg. Recovery
100% or more	310	$11.9	$11.9	100%	$11.9
75% - 100%	44	19.4	16.4		16.4
50% - 75%	46	30.1	19.6	50%	9.8
25% - 50%	53	41.4	15.3		7.6
0% - 25%	59	28.4	4.4	0%	-0-
None	558	18.8	-0-		-0-
Total	1,070				

Source: Credit Research Center Bankruptcy Study

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EXHIBIT 5

SAMPLE CALCULATION--60 MONTHS PAYMENT SCHEDULE--STEP 3

Aggregate annual amount of affordable debts estimated to be recoverable from 1,070 Chapter 7 debtors:	$ 5,281,347
Aggregate annual amount of affordable debts estimated to be recoverable from Chapter 7 debtors nationally at annual bankruptcy rate of 315,000:	
$\frac{315,000}{1,070}$ x $5,281,347	= $1,554,789,070
	= $1.6 billion

EXHIBIT 6

AFFORDABLE DEBTS RECOVERABLE UNDER

DIFFERENT ASSUMPTIONS

(Dollar Amounts in Millions)

Payment Schedules	Affordable Debts	Percent of Non-mortgage Debts	Recoverable Affordable Debts[a]
36 months			
Basic living expenses	$1,476	24.7%	$1,103
Basic living expenses +20%[b]	1,221	20.4	870
48 months			
Basic living expenses	1,708	28.6	1,349
Basic living expenses +20%[b]	1,429	23.9	1,113
60 months			
Basic living expenses	1,883	31.5	1,555
Basic living expenses +20%	1,589	26.6	1,277

[a]Under assumptions specified in text.

[b]Of non-housing expenses

Source: Credit Research Center Bankruptcy Study

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EXHIBIT 7

MEAN PRE-TAX INCOME OF DEBTORS AND NON-MORTGAGE DEBT

THAT COULD BE REPAID IN 60 MONTHS

Percentage of Non-Mortgage Debt Repaid[a]	Mean Non-Mortgage Debt	Mean Pre-tax Income[b]
100% or more	$11,945	$17,058
75% to 100%	19,420	15,335
50% to 75%	30,061	14,687
25% to 50%	41,417	13,374
0% to 25%	28,397	10,802
None	18,776	5,650

[a]Assuming coverage of basic living expenses.

[b]Before taxes and transfers.

Source: Credit Research Center Consumer Bankruptcy Study.

Senator HEFLIN. Our next witness is Claude Rice of McDowell, Rice & Smith, Kansas City, Kans.

STATEMENT OF CLAUDE L. RICE, ATTORNEY, McDOWELL, RICE & SMITH, KANSAS CITY, KANS.

Mr. RICE. Thank you, Mr. Chairman.

I am Claude Rice, an attorney in Kansas City, Kans. I have been practicing law for longer than I would like to admit.

I served as a chapter 13 trustee for over 25 years and am presently the executive of a company which provides data processing services to other chapter 13's around the United States. At the present time, we are serving in over half of the chapter 13 cases pending in the United States.

I have included a number of comments and suggestions in the written statement, and I propose to limit my oral comments, as suggested, to only a few.

I would first like to discuss the question of the discharge hearing that is presently required in a completed chapter 13 case. We think that is unnecessary and inappropriate and have pointed out the reasons for it.

Another rather serious problem insofar as chapter 13 trustees are concerned is the question of their compensation and expense in cases that are not confirmed.

The Administrative Office of the U.S. Courts has interpreted the present statute to prohibit any allowance to a trustee in a case that

is not confirmed, even though the statute requires a trustee who interviews the witness to incur a substantial amount of expenses and time. If the case is not confirmed, the trustee is not permitted compensation or expenses reimbursement. We think there are a lot of occasions where it is inappropriate and unrealistic.

The present 3-year limit on the length of a chapter 13 plan is also a burdensome problem. There is little relief for a debtor if he is required to condense the payments of a 4-year car loan into a 3-year plan.

The present language of section 1322(c), which requires the court to find cause before permitting a plan to extend, is a disservice both to the debtor and to the creditor. We suggest the limitation should be changed. I do not suggest that the statute require the debtor to commit to a longer plan but, rather, urge that the debtors be permitted to extend payments for a longer period if they desire.

The initial length of the plan is a choice that is made by the debtor. The mandatory limit is a restriction on the debtor's ability to pay commensurate with his ability. A short time limit is of no benefit to the debtor; it merely forces the well-intentioned debtors to attempt a payment schedule greater than they are actually able to maintain.

Statistics which we have maintained in our service for over 15 years have indicated that those debtors whose cases are dismissed or converted to liquidation have been those debtors who have attempted to pay from $5 to $10 a week more than those that are successful. We have attached a series of reports to illustrate that, and the reports go back—and not in random samples of the closed cases—we are looking at about 130,000 actual cases of real, live people.

The question of a particular type of a discharge that is granted in a chapter 13 I would like to address. There has been considerable publicity and a great deal of media attention to the horrible examples of those debtors who have been guilty of fraudulent practices or have caused malicious injury to others and then used a chapter 13 proceeding to discharge this liability with a nominal or ridiculously small payment. The available statistics indicate that these types of cases have a minimal financial effect on the system, but to my mind they create a heavy moral burden to the entire system.

To espouse a system that grants favored treatment to persons who have admittedly been guilty of fraudulent or malicious conduct seems to me to be akin to being against motherhood and in favor of sin. I do not believe that an unrestricted discharge of this type of debt can be socially justified. I suggest that the statute as originally drawn did not intend to permit such relief, and I have outlined why. But most of the courts have not so interpreted the statute.

In the view of most of the present case law, a statutory change is appropriate. We strongly urge that you do not destroy the concept of a complete and unconditional discharge in a chapter 13 case but, rather, require the chapter 13 plan to include and pay the collectible portion of such types of debts before the plan is completed and then let the debtor have a complete discharge.

We would urge that the plan require that fraudulent and malicious debts be dealt with by the plan in an equitable manner but that when the debts have been paid in an equitable manner, as determined at the time the plan is confirmed, and when the plan is completed, the debtor be given a full discharge.

I appreciate your subcommittee's attention and stand ready to answer any questions you have.

Senator HEFLIN. Mr. Rice, I wonder if you would give us your personal feeling as a practitioner about the effect a future earnings test would have on litigation loads in bankruptcy courts and whether or not such a test would have the effect of improving debt recovery in bankruptcy proceedings.

Mr. RICE. My personal experience would indicate to me that there will not be any increase in the court load, for this reason. I am referring now to the proposed legislation. That anticipates that there are no issues before the courts until some interested party makes an issue of it. My experience would indicate to me that there is a minimum number of cases in which there is going to be any serious argument.

The debtor has to make a statement of what his income and expenses are, and it is going to be rather obvious from that whether the guy can or cannot pay his bills. If the creditor wants to contest the validity of the statement—that it is a false statement—that is not going to be difficult to determine. Very quickly these matters will settle down to a minimum amount of litigation.

I heard the same type of hues and cries of the terrible work that was going to be imposed on the bankruptcy courts went they went into the dischargeability question—giving the bankruptcy courts that jurisdiction. The courts had a flurry of cases for about 6 months, and it settled down rather quickly.

I might refer though to personal experience in chapter 13. The courts have taken an awful lot of time in chapter 13's, where they do not have any experience with them. That is not true in the areas where they have had some experience.

In my personal experience, at the time I quit taking new cases I had 3,300 active cases pending. The bankruptcy judge only came to town 1 day a month. It did not take up a lot of the court's time. That is not going to be true in a new area where the bar and the creditors all have to be educated. Nobody in our community felt they were short shrifted, and we certainly did not take up a great deal of the court's time. I think the same thing would happen on this issue.

Senator HEFLIN. What is your opinion of the future earnings concept which has been advanced by the National Coalition for Bankruptcy Reform? Would it be beneficial to the public at large?

Mr. RICE. Not only do I think it would be beneficial to the public at large, but I think the image of the court system—and I am not trying to quote Senator DeConcini, but I have friends, not associated with the Bankruptcy Act, who are consistently shocked at the idea that the ability somebody has to pay is not even an issue in the present bankruptcy law.

I have had a thousand people over my life say to me, "Why did the judge let him do that? He can afford to pay." They are shocked when you tell them it is none of the judge's business whether he

can afford to pay under the present statute. That is what I think should be changed. I think the public and the court system as a whole would be substantially benefited by that type of a test.

Senator HEFLIN. All right. Thank you, sir. We appreciate your help.

[The prepared statement and other submissions of Mr. Rice follow:]

Prepared Statement of Claude L. Rice

MR. CHAIRMAN:

I would like to introduce myself. I am Claude Rice, an attorney from Kansas City, Kansas. I served as a Chapter 13 trustee for over 25 years and presently am an executive of a company which provides data processing services to courts, attorneys and trustees in the processing of bankruptcy cases, principally Chapter 13 cases.

I have assumed the Committee is interested in my views on the operation of the Bankruptcy Code principally as applied to Chapter 13 cases. I will restrict my comments principally to the effect of the Code on Chapter 13 proceedings and will refer to other Sections of the Code only as they may affect Chapter 13 cases and their administration.

First, it is my view that the Bankruptcy Reform Act has been basically beneficial and has substantially improved the availability and the utility of Chapter 13 relief. One, if not the most important, improvement is the concept of the automatic stays which restrain extra judicial activity and prohibit post-petition pressures on the debtors and their families. I urge this concept be retained. The concept may even need expansion.

I suggest that the following problems be addressed by your Committee and the Congress:

1. Discharge hearing required by Section 524(d) - At the time of the discharge hearing a Chapter 13 debtor's financial affairs would have been under the supervision of the court's trustee for several years, his obligations with the exception of alimony and child support have been fully discharged and there are no debts to be reaffirmed. At that stage there seems little reason to burden the court and the debtor with an additional hearing in connection with the discharge. In a Chapter 7, a separate discharge hearing may

be justified in order that the debtor be aware of the judicial nature of the proceeding. In a Chapter 13 case the debtor's financial affairs have been under the court's jurisdiction for an extended time, usually three or more years. Another hearing will add little to the debtor's awareness of the judicial nature of the proceeding. We suggest that Section 524(d) be amended by substituting "1328(b)" for "1328" where it appears in the first sentence of 524(d). The sentence would then read:

> "In a case concerning an individual, when the Court has determined whether to grant or not to grant a discharge under Section 727, 1141 or 1328(b) of this title, the court shall hold a hearing at which the debtor shall appear in person."

The discharge directed by Section 1328(a) is not discretionary in any event. Section 1328(a) directs that "after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this Chapter, the court SHALL grant the debtor a discharge . . .." The phrase, in the present Section 524(d)

> "when the court has determined whether to grant or not to grant a discharge"

has no application to a discharge pursuant to Section 1328(a).

2. Trustee's compensation and expense - A standing trustee's compensation and expenses are provided by Section 1302(e) [28 U.S.C. 586(e) for the U. S. Trustee districts] and limits those allowances to a percentage not to exceed ten (10%) of "all payments under plans." This provision is adequate for those cases in which the plans are confirmed and which deal with both secured and unsecured debt. The Administrative Office interprets this language to prohibit a trustee from collecting either compensation or expenses in a case in which the debtor's plan is not confirmed. Thus, even though a standing trustee may spend a considerable amount of time, effort and money in processing a Chapter 13

case to perform the duties directed by Section 1302(b) such as the investigation of debtor's financial affairs, the preparation for and attendance at the meeting of creditors, and hearings on confirmation, no compensation or expense is allowable for this effort if the case is not confirmed. The cost and expense of handling these aborted cases is shifted to those debtors whose plans are confirmed. We recommend a statutory change which would permit the court to approve a minimum charge per case in the event the percentage amounts did not reach such a minimum total sum whether or not a plan was confirmed. Suggested language for resolving the problem would be to amend Section 1302(e)(1)(B) by adding the following proviso:

> "Provided that the court may approve a minimum collection not to exceed [a reasonable sum ($25.00 suggested)] for the expense and compensation of the trustee and such collection may be made whether or not a plan is confirmed."

The present compensation scheme of 10% of the funds handled by the trustee to cover both compensation and expense is adequate, provided, the plans are not distorted by attempts to handle debts "outside the plan." We suggest that the only claims which should be outside the plan are those claims described in Section 1322(b)(2) as claims that may not be modified by a plan. In this connection, attached is a copy of a memorandum written on the subject. At least one court has held that even the debt secured by a mortgage on the debtor's home (which debt cannot be modified by the plan), must be paid through the plan and that the trustee shall charge compensation and expenses for such payments. There seems to be logical support for this position as the statute now reads. However, the extra work and expense involved in handling such debt through the trustee's office does not seem necessary and we would suggest that the statute be amended to clarify this issue. I suggest that Section 1322(a) be amended by adding a new subparagraph (4) pro-

viding that the plan shall:

> "(4) provide for all claims against the debtor or the debtor's property except future payments to become due on those debts secured only by a security interest in real property that is the debtor's principal residence as described in subsection (b)(2) of this section."

Such a modification will clarify the present confusion and assure the inclusion within the plan of all debts which may be modified by a plan. The charge for handling the current home mortgage payments within the plan is disproportionate to the actual cost involved. Such claims cannot be modified by a Chapter 13 plan in any event. [1322(b)(2)]

3. Immediate payment to trustee - In a number of districts the debtors are expected to and do commence making payments to the trustee immediately upon the filing of the case and we suggest that adequate authority for such procedure is presently in the statute. However, the language contained in Section 1325(b) has led some courts to conclude that the debtor should not make payments immediately upon filing of the case.

4. Duration of plan - I reiterate my caution expressed earlier with respect to the time restraints on the length of debtors' plans. Experience for many years prior to the adoption of the Code indicated that many successful plans needed more than three years to complete. With the advent of current high interest rates and longer periods for normal financing of consumer items, a three year restriction on plans seems unnecessary and burdensome to debtors. My suggestion to your Committee is that Section 1322(c) be modified to provide:

> "The plan may not provide for payments over a period that is longer than five years, unless the court, for a cause approves a longer period."

I do not suggest that the statute require debtors to commit to longer plans but rather urge that the debtor be permitted to extend the payments over a longer period. The initial

length of the plan is a choice made by the debtor. A mandatory limit is a restriction on the debtor's ability to propose a feasible plan commensurate with his ability to pay. The short time limit is no benefit to the debtor. It merely forces well intentioned debtors to attempt a payment schedule greater than they are able to maintain.

The statistics which we have maintained have consistently indicated for over 15 years that those debtors whose cases are dismissed or converted to liquidation cases have attempted to pay from $5.00 to $10.00 per week more than those debtors whose cases are successfully completed.

In this connection, we attach a series of reports and charts which display the effect of limiting the length of the debtor's plan. Briefly stated, an extension of the period of time which the plan is allowed to extend can substantially reduce the debtor's monthly payments and improve the net return to creditors.

5. Confirmation Hearing - Another burden on the speedy and expeditious administration of Chapter 13 cases is the perceived requirement by a number of courts that the court has an independent responsibility to examine the plan, the parties and the claims and make an independent determination with respect to the requirements of Section 1325 even though there has been no question raised by interested parties. I suggest that the procedure followed by those courts is not only an unnecessary burden on the parties but consumes an inordinate amount of judicial time which should not be required unless some party in interest chooses to raise an issue. Many of the courts have viewed the present language of Section 1325 to require the court to receive and evaluate evidence to positively establish that the requirements of Section 1325 have been met even though no objection has been raised.

I submit that the statutory standards provide an adequate foundation upon which interested parties may base objections to the plan. Unless an interested party advises the court that the proposed plan fails to meet those standards in some particular the court should not be required or expected to make independent inquiry. A suggested manner of eliminating this administrative determination from the perceived responsibility of the court would be to add to Section 1325 a new subsection (c) as follows:

> (c) The plan shall be deemed to comply with the requirements of subparagraphs 1, 3, 4, 5 and 6 of this section unless a party in interest, including the trustee, shall have filed a written objection to the confirmation of the plan for failure to comply with one or more of such subsections.

Such an amendment would preserve to creditors the right to require the statutory standards but remove the court from making determinations unless an interested party raised an issue.

6. Nature of the Discharge - An important item which we wish to discuss is the so-called "super discharge" provided by Section 1328(a). This section provides that a debtor who has completed a plan be discharged from all debts except those which were intended to be extended beyond the life of the plan [1322(b)(5)] and for alimony and maintenance of a spouse or child. There has been considerable publicity and a great deal of media attention to the horrible examples of those debtors who have been guilty of fraudulent practices or malicious injury to others who have used Chapter 13 as a means of paying a minimum amount to creditors and received a discharge from their maliciously incurred debts. The available statistical information indicates that these cases have a minimal financial impact on the system but they do constitute a heavy moral burden. The unlimited discharge of such debts is of benefit only to those individuals who incurred an obligation of the following types:

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1. Obtaining money by false pretenses or fraud. [Section 523(a)(2)]

2. Debts not scheduled. [Section 523(a)(3)]

3. Fraud or embezzlement while acting in a fiduciary capacity. [Section 523(a)(4)]

4. Willful or malicious injury. [Section 523(a)(6)]

5. Fines and penalties to governmental units. [Section 523(a)(7)]

6. Educational loans. [Section 523(a)(8)]

7. Debts previously denied discharge. [Section 523(a)(9)]

To espouse a concept that grants favored treatment to persons guilty of the described activities seems akin to being against motherhood and in favor of sin. I question whether unrestricted discharge of this type of debt can be socially justified. It was my opinion at the time the statute was originally adopted that Section 1325(a)(4) would prevent the discharge of such debts unless the plan proposed the payment of what could have been collected on such debts after a discharge under Chapter 7.

Section 1325(a)(4) provides that prior to confirmation the plan must provide to each unsecured creditor "not less than the amount that would be paid on such claim if the estate were liquidated under Chapter 7 of this Title."

I had assumed that Section 1325(a)(4) as enacted was intended to require confirmation of a plan, if, and only if, unsecured creditors were to be no worse off under the Chapter 13 plan than they would have been in a Chapter 7 case. This was described as a "best interest of creditors test."

However, many courts have not so interpreted this section. Those courts have read the phrase

> "not less than the amount that would be paid on such claim"

as though it were written

53(7)

"not less than the amount that would have been distributed on such claim under Section 726 of this Title."

The following is an excerpt from an opinion of the Bankrupty Court for the Northern District of Illinois. In re William H. Blossfeld, 8 BCD 44:

> To adopt the application of section 1325(a)(4) as proposed by Edgcomb would require the Court to speculate as to the total amount Edgcomb would eventually recover on its claim in the hypothetical chapter 7 and subsequent thereto through post bankruptcy collections and supplemental proceedings. Such speculation is not warranted. This is especially so since the language of section 1325(a)(4) as written [5] requires that the amount paid on a claim under the plan be "not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 . . ." It does not say that the amount paid on a claim under a plan be not less than the amount that would *eventually* be paid and/or collected on such claim. If Congress had intended the application of section 1325(a)(4) proposed by Edgcomb, and had intended that bankruptcy courts indulge in the speculation requested by Edgcomb, Congress could have expressly stated so.

This language states the position taken by a majority of the Bankruptcy Courts. As a result, any creditor with the type of claim described in Section 523(a) is not "as well off" as if a debtor had filed a Chapter 7 case. This interpretation thwarts the "best interest of creditors test."

I suggest that a Chapter 13 plan should provide for the payment of the affordable portion of any 523(a) debts and upon the completion of the plan the debtor receive a full discharge of all debts as now provided by Section 1325(a).

Some courts have adopted this theory but a majority have not. As a result, the Chapter 13 proceeding is being used to avoid fraudulent debt with a minimum payment to creditors. As we stated earlier, the amount of dollars involved is minimal but the emotional impact has been serious.

In view of the present case law a statutory change is appropriate. To accomplish the suggested change Section 1322(a) or Section 1325(a)(4) should be amended to require payment of debts defined in Section 523(a)(2), (3), (4),

53(8)

(6), (7), (8) and (9) to be paid not less than could reasonably be collected by legal process within three years in the event that the estate of the debtor were liquidated under Chapter 7.

Historically the Chapter 13 trustees took pride in helping people who were conscientious in trying to pay their debts. The trustees are now finding themselves assisting dishonest debtors and they feel helpless to prevent the abuse. However, I urge the Committee to make the adjustments by requiring the affordable portion of Section 523(a) debts to be paid by the Chapter 13 plan and not by eliminating the complete discharge now provided by Section 1328(a). The debtor should pay the amount that he can afford to pay and then given a true "fresh start."

We appreciate your Committee's attention and the opportunity to present our views. We stand ready to answer questions or provide additional information which may be requested.

ELECTRONIC PROCESSING INCORPORATED

P. O. BOX 1340
KANSAS CITY, KANSAS 66117
(913) 371-3230

MEMORANDUM: Should All Claims, Both Secured and Unsecured, Be Paid Under the Plan?

FROM: Claude L. Rice

Section 541 creates an estate which includes all interest of the debtor in any property. There is no provision for disposing of or dealing with any property of the estate except in accordance with a plan under Chapters 9, 11 or 13 or liquidation by a trustee under Chapter 7.

No place in the code is there a provision for handling of claims against an estate (Chapters 7, 11 or 13), "outside" of the case. Section 1329(a)(3) permits a confirmed plan to be modified "to the extent necessary to take account of any payments of such claim other than under the plan." This section is necessary to account for payments of claims made by

Credit Life Insurance, or a co-debtor who wants to pay the claim.

The plan should not be confirmed except in compliance with the provisions of Section 1325. Section 1325(a)(5) provides that the holder of each secured claim must either (A) accept the plan (there is no deemed acceptance, it must be actual acceptance), or (B) the creditor shall receive "under the plan" a stream of payments with a value of not less than the amount of the claim. Section 1325(a)(5) provides only three methods of dealing with secured claims:

A. The creditor "accepts" the plan of treatment.

B. Pay present value of claim by distribution under the plan.

C. Surrender the property.

Section 362 requires that the automatic stay shall be lifted for lack of adequate protection. Section 361 provides that adequate protection may be provided by "(1) requiring the trustee to make periodic cash payments to such entity." There is no provision for "adequate protection" payments to secured creditors outside the plan - only by the Trustee.

It is well to recall that the estate in a Chapter 13 case includes, not only the property specified by Section 541 but

> ". . . in addition to the property specified in Section 541 of this Title --
>
> (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed . . ., and
>
> (2) earnings from services performed by the debtor . . ." (Section 1306)

The only provision in the Code for distributing property of the estate is in Section 1326(b). Even though the legislative history indicates that "1326(b) makes it clear that the Chapter 13 trustee is normally to make distribution to creditors of the payments under the plan by the debtor." Section 1326(b) does contain the phrase "except as otherwise provided in the plan . . ."

It could be that a plan might provide for a distribution directly to a creditor from a spendthrift trust or other third party. But such distribution by other than the trustee does not affect the trustee's allowance for fees. The basis for the allowance of the trustee's fees is set forth in Section 1302(e)(2) which provides:

> "(2) Such individual shall collect such percentage fees from all payments under plans in the cases under this chapter for which such individual serves as standing trustee." (emphasis supplied)

Since the fee to be collected by the trustee is to be based upon ALL payments whether made by the trustee or someone else there is no purpose in not having the trustee make all of the payments.

One of the more effective prohibitions against the pay-

ment to creditors "outside" the plan is the unequivocal language of Section 362(a)(3) and 362(a)(6). These sections act as a stay, applicable to all entities (which necessarily includes all creditors), of

> "(3) Any act to obtain possession of property of the estate or of property from the estate;
>
> [or]
>
> (6) Any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this Title."

The committee reports indicate a clear intention to "prevent creditors from attempting in any way to collect pre-petition debts."

The effect of these statutory mandates are to restrain unequivocally any act to collect a claim that arose before the commencement of the case from (1) the debtor or from (2) property of the estate. The grounds for relief from the stay are set out in paragraph 362(d). These grounds include no hint of any authority for lifting the stay to accommodate some extra-judicial promise or agreement. As a matter of fact, Section 524(c) seems to be a clear statement of legislative policy against any extra-judicial settlements with respect to pre-petition debts.

In view of these sections, it seems clear that all creditors are forbidden to accept any payment outside the case even if the debtor wants to make such payments.

GOOD FAITH

There is no case law defining the term "good faith" as applied to the old Chapter XIII. Most of the case law on the subject was written as applied to the old Chapter X under which a determination of a good faith filing was required.

One of the statutory grounds under the old Act for failing to meet the good faith requirement (Section 146(2)) was that one of the other chapters was a more appropriate relief. I suggest that dealing with part of the assets and debts under Chapter 13 is not a good faith use of Chapter 13 and a plan that does not provide for all of the property of the estate, and all of the claims against the debtor, is not a good faith use of the proceeding. Such would seem to be an attempt to distort the statutory scheme.

The foregoing comments are given support by Section 524(c) which requires court approval of any agreement to pay a creditor outside the Bankruptcy Court even after discharge under Chapter 7. An attempt to handle claims of any kind outside a Chapter 13 case, if permitted, might well have the effect of bypassing Court participation in the debtor's dealings with these creditors, which is clearly contrary to Congressional intent.

I earnestly suggest that the treating of either assets or claims "outside" the plan is neither authorized nor permitted by the Code.

CLR:vl

12/3/79

53(11)

Summary of Data of Chapter 13 Cases

We have maintained a summary of data about each Chapter 13 case for which we have prepared the final or closing report.

Analysis of this data has always indicated that those debtors who were unable to complete their plans, those debtors whose plans were dismissed or converted to liquidation cases, were those debtors whose proposed payments were 5 to 20 percent greater than the payments proposed by those debtors who completed their plans.

Many of the families who use Chapter 13 are living on the edge of economic disaster and for these families five or ten dollars per week can make the difference between what can and what cannot be done.

I enclose two pages of the Analysis of Closed Cases. One page covers all cases in which final reports were written for the last twenty years and covers the period 1960 to June, 1981.

The second report includes those cases in which final reports were filed in the last year, July 1, 1980 to June 30, 1981. In both of these summaries it should be observed that the debtors whose plans were successfully completed averaged more than 36 months and always provided for smaller monthly payments than those cases which were dismissed or converted to liquidation cases.

These summaries illustrate the thinness of the line between success and failure.

ANALYSIS OF DEBTORS PERFORMANCE

[July 1980 thru June 1981]

Overall totals	Completed	Dismissed	Not confirmed	Adjudicated	Other	Total
Number of cases	5,994	8,590	2,421	2,727	503	20,235
Percent of total	29.621	42.451	11.964	13.476	2.485	100.000
Average number of months active	35.73	19.63	5.40	11.48	19.44	21.59
Average monthly payment expected	176.34	204.32	205.33	226.27	176.59	198.42
Average monthly payment received	151.88	104.81	26.55	115.60	88.72	125.95
Number of claims	66,628	85,188	8,063	24,551	3,658	188,088
Average number of claims per case	11.11	9.91	3.33	9.00	7.27	9.29
Amount allowed	30,279,995	50,810,832	5,724,973	16,157,905	2,319,332	105,293,037
Amount allowed average per case	5,051.71	5,915.11	2,364.71	5,925.15	4,610.99	5,203.51
Amount paid—principal	27,786,806	13,726,659	269,704	2,737,408	707,156	45,227,733
Average per case	4,635.77	1,597.98	111.40	1,003.81	1,405.87	2,235.12
Interest	264,191	363,476	3,108	72,753	13,679	717,207
Average per case	44.07	42.31	1.28	26.67	27.19	35.44
Total	28,050,997	14,090,135	272,812	2,810,161	720,835	45,944,940
Average per case	4,679.84	1,640.29	112.68	1,030.49	1,433.07	2,270.56
Percent of allowed that was paid	92.638	27.730	4.765	17.391	31.079	43.635

ANALYSIS OF DEBTORS PERFORMANCE

[January 1960 thru June 1981]

Overall totals	Completed	Dismissed	Not confirmed	Adjudicated	Other	Total
Number of cases	57,332	57,310	7,647	14,461	1,762	138,512
Percent of total	41.391	41.375	5.520	10.440	1.272	100.000
Average number of months active	37.53	20.73	4.16	14.94	32.81	26.31
Average monthly payment expected	135.74	145.28	175.34	169.61	136.83	145.42
Average monthly payment received	120.28	75.90	22.29	91.23	78.83	102.58
Number of claims	663,782	609,016	27,243	154,327	18,741	1,473,109
Average number of claims per case	11.57	10.62	3.56	10.67	10.63	10.63
Amount allowed	232,437,196	249,449,004	13,957,884	71,647,797	8,127,319	575,619,200
Amount allowed average per case	4,054.23	4,352.62	1,825.27	4,954.55	4,612.55	4,155.73
Amount paid—principal	219,683,449	69,921,615	494,062	15,042,469	3,754,642	308,896,237
Average per case	3,831.77	1,220.05	64.60	1,040.20	2,130.89	2,230.10
Interest	2,199,397	1,442,225	5,179	227,689	50,757	3,925,247
Average per case	38.36	25.16	.67	15.74	28.80	28.33
Total	221,882,846	71,363,840	499,241	15,270,158	3,805,399	312,821,484
Average per case	3,870.13	1,245.22	65.28	1,055.95	2,159.70	2,258.44
Percent of allowed that was paid	95.459	28.608	3.576	21.312	46.822	54.345

The attached charts are drawn to illustrate the effects of varing lengths of time for the plan to be completed on:

(1) the amount of payments the debtor needs to make; or

(2) the amount of money which the creditors would receive if the payments were not changed.

The first two charts (the ones with the curved lines) indicates on the vertical dimension the dollars per week needed and the horizontal dimension indicates the length of time those payments would need to be maintained in order to pay 100 cents on the dollar to all allowed claims. One chart is based on the composite case. The second is based on the dollars per week to pay $1,000 of indebtedness.

The other two charts indicate the percentage which would be paid to creditors if the debtors payments were to continue various lengths of time.

One chart illustrates the effect of time the plan extends on all creditors. The other chart illustrates the effect of longer plans on payments available to unsecured creditors.

It is obvious from examining these charts that the length of time for which the debtor's plan may be proposed has a profound impact both on the amount of money that the debtor needs each pay day to meet the requirements of a plan or the amount of money which creditors will be paid or both.

It should be noted that the statute presently requires the secured creditors to retain their liens and be paid under the plan amounts not less than the value of their security. It is the unsecured creditors whose interest can be adversely affected by a Chapter 13 plan. This is the group that represents the merchants, bankers, credit cards, doctors and other small business interests. These claims represent only 51% of the dollars claimed but over 73% of the number of creditors involved.

This summary accumulates the data with respect to 35,067

separate cases into a composite. On the assumption that the accumulation of all of the data from all of these cases is a representative case, the composite case is as follows:

	Scheduled	Claimed	Percent	Paid	Balance
Secured	6,533.35	4,178.38	99.28%	1,034.40	3,112.12
Priority	406.03	350.69	99.92%	70.68	272.71
Unsecured	7,273.34	5,463.52	69.99%	365.98	3,452.43
Other Claims	231.63	204.79	96.73%	103.94	94.15
TOTAL	14,444.35	10,197.38		1,575.00	6,931.41
Miscellaneous payments to "unfiled" or "Outside" claims				2.56	
Interest Paid to Creditors				74.72	
Total Distributed to Creditors				$1,652.28	

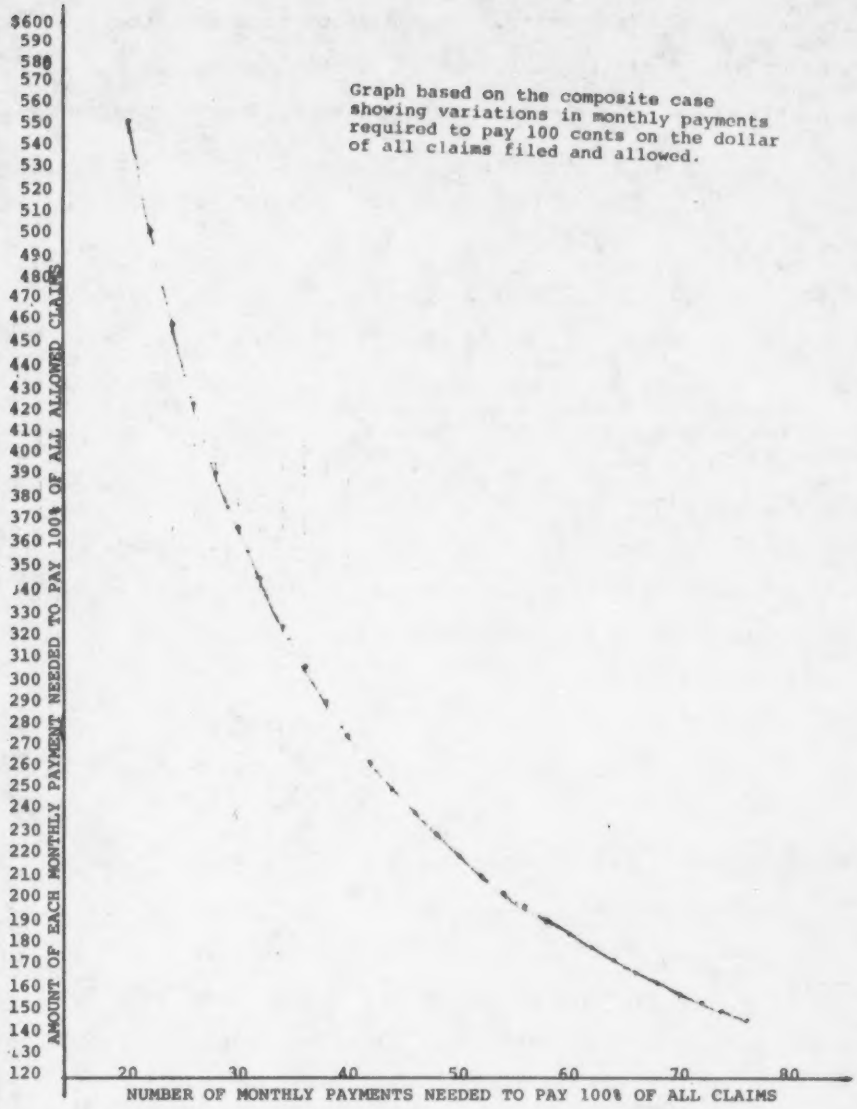
Debtor's proposed payments to trustee - $215.29/monthly.

Payments to date to trustee total $2,234.30.

Distributions by Trustee:	
Creditors	$1,652.28
Attorney for Debtor	269.77
Clerk of Court	13.29
Trustee Expense and Compensation	199.58
Undistributed Funds	99.38
Total	$2,234.30

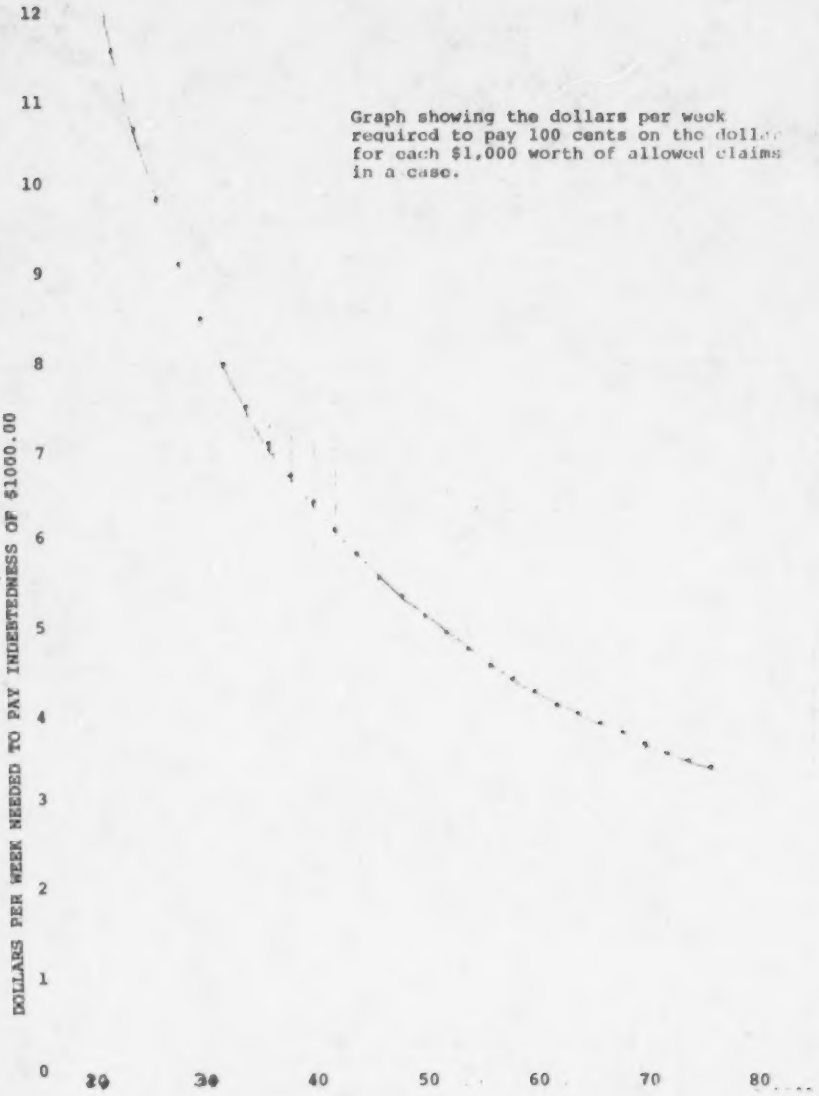
Some of the graphs attached to the memorandum are based on a debtor and plan constructed from this composite case.

53(15)

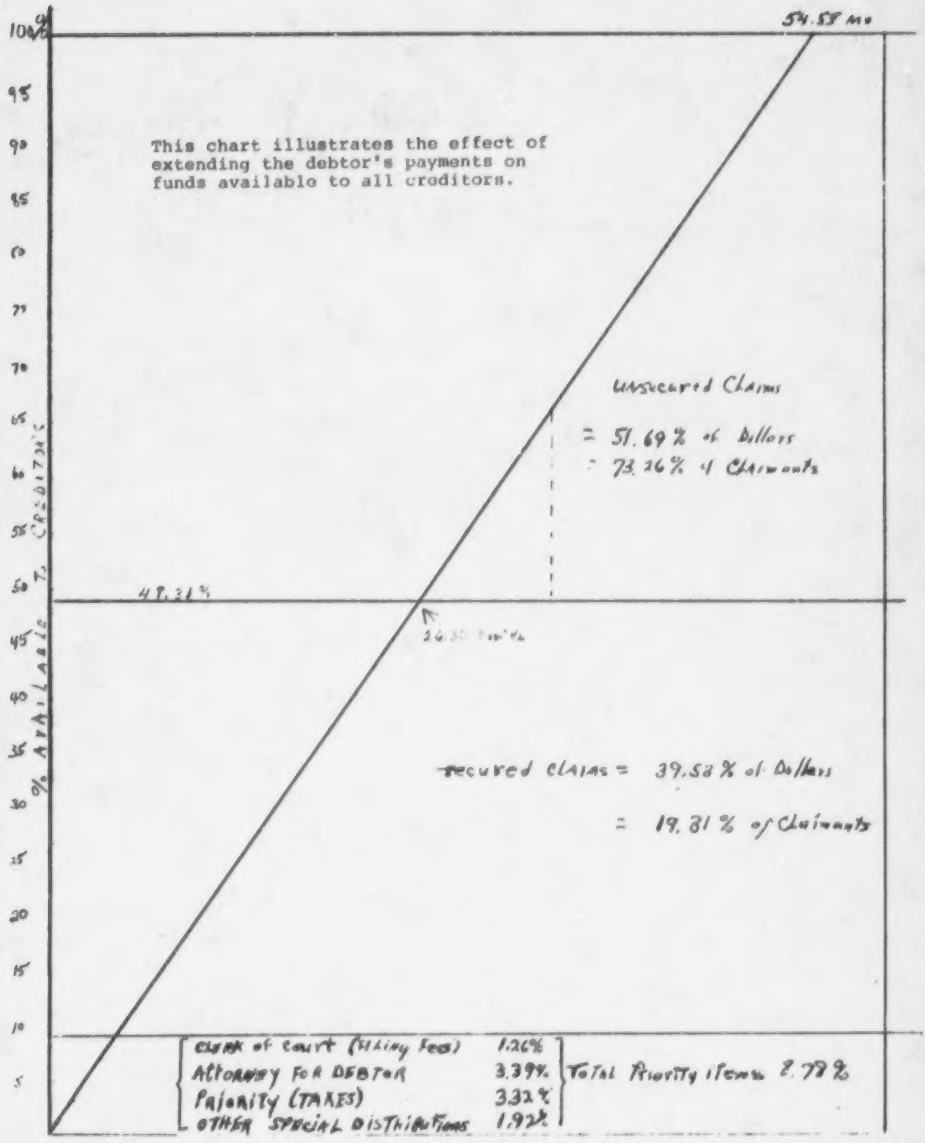


Graph based on the composite case showing variations in monthly payments required to pay 100 cents on the dollar of all claims filed and allowed.

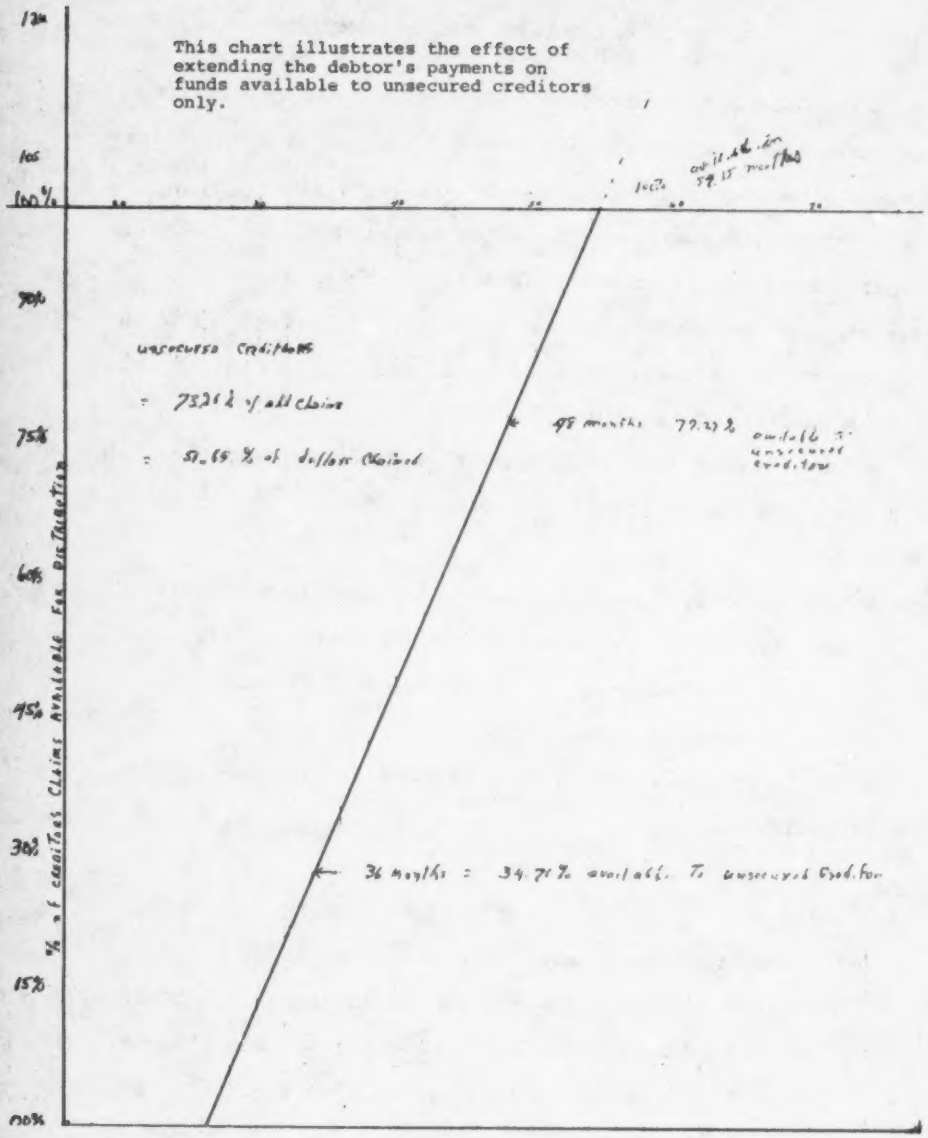
53/14)


Graph showing the dollars per week required to pay 100 cents on the dollar for each $1,000 worth of allowed claims in a case.
DOLLARS PER WEEK NEEDED TO PAY INDEBTEDNESS OF $1000.00
0
1
2
3
4
5
6
7
8
9
10
11
12
20
30
40
50
60
70
80

53(17)


54.58 Mo
This chart illustrates the effect of extending the debtor's payments on funds available to all creditors.
Unsecured Claims
= 51.69 % of Dollars
= 73.26 % of Claimants
49.21%
% CREDITORS
% AVAILABLE
Secured claims = 39.58 % of Dollars
= 19.81 % of Claimants
CLERK of COURT (Filing Fees) 1.26%
ATTORNEY FOR DEBTOR 3.39%
PRIORITY (TAXES) 3.32%
OTHER SPECIAL DISTRIBUTIONS 1.92%
Total Priority Items 8.78 %

53(18)


This chart illustrates the effect of extending the debtor's payments on funds available to unsecured creditors only.
120%
100%
100%
90%
75%
60%
45%
30%
15%
0%
% of creditors Claims Available For Distribution
unsecured Creditors
= 73.21 % of all Claims
= 51.69 % of dollars Claimed
48 months 77.23 % available to unsecured creditors
36 months = 34.71 % available To unsecured Creditors

5319

CRITERIA FOR DETERMINING THE AMOUNT
AVAILABLE FOR UNSECURED CREDITORS

The debtors' proposed monthly payments to the trustees was reduced by 10% on the assumption that the allowances for trustees' expenses and compensation would be 10%.

This would leave available for distribution to claimants ninety cents out of each dollar paid to the trustee. (Actual charges for the cases examined averaged only 8.932% - but an assumption of 10% was used because in many districts the full 10% is needed and is allowed.)

The analysis further assumes that from the funds available for distribution to creditors payments in full must be proposed for:

1. Attorney fees for debtor's attorney [§513(b)(4)],
2. Section 507(a) priority claims [§1322(a)(2)], and
3. Allowed secured claims [§1325(a)(5)], and
4. Other creditors. (special distributions)

Thus the funds available under a plan as dictated by statute is as follows --

Payments proposed by debtor

Less:

A. Trustee comepnsation & expense [§1302]

B. 100% of fees allowed debtor's attorney [See §1322(a)(2)]

C. 100% of other 507(a) priority claims [See §1322(a)(2)]

D. 100% of allowed secured claims [See §1325(a)(5)]

E. 100% of "other" debt allowed. (This may or may not be required, but for the purpose of this analysis these payments were presumed to be required.)

Balance of payments by the debtors are presumed available for distribution to unsecured creditors.

It is not necessary that payments to unsecured creditors be deferred in time until the preference items are paid in full (possible exception of attorney's fees - see §1326(a)(1) but in calculating the total funds available to be distributed,

these items must be calculated at 100% to determine what, if any, funds will be available for distribution to unsecured creditors.

The computer system used permits the handling of claims that do not fit in one of the standard classifications. These claims have been collected under the caption "OTHER". These "OTHER" claimants constitute a myriad of types but principally items such as current alimony payments, current mortgage payments, refunds to the debtors and other types of distribution that may be made for the convenience of the debtor. In many instances the amount of these items are not proposed to be fully liquidated under the plan and frequently the funds paid on these claims are not considered as "payments under plan" on which the trustee's charges are to be based. However, we have assumed for the purpose of these calculations that these are debts that must be paid in full during the plan and that the trustee's fees and expenses will be charged on account of all such claims.

The analysis reflects the information from a "snap shot" look as of 9-1-81 of 35,067 cases that were filed during calendar year 1980. These cases represent the latest annual period in which the time within which claims may filed by creditors has expired. The data represents actual cases and actual claims as filed and allowed.

Total Cases	35,067
Total Claims (scheduled or filed)	505,264
Total Debt Listed by Debtor (scheduled)	$506,520,167
Total Claims Filed by Creditors and Allowed	$357,591,843
Less Than Scheduled	$148,928,324
Per Case Average Listed by Debtor	14,448.35
Per Case Average Claimed by Creditor and Allowed by Court	10,197.39
Difference (Average per Debtor)	4,246.96

53(21)

Percent by Which Allowed Claims were Less Than Scheduled Debts		29.4%
Unsecured Debt Only		
Total Unsecured Debt Scheduled		$255,054,049
Total Unsecured Debt Filed and Allowed		$191,589,412
Less Than Scheduled		$ 63,464,637
Per Case Average Scheduled		7,273.33
Per Case Average Filed and Allowed		5,463.52
Difference		1809.8%
Percent of Scheduled Debt		24.8%
Secured Debt Only		
Secured Debt Scheduled		$229,104,993
Secured Debt Filed and Allowed		146,523,279
Less Than Scheduled		82,581,714
Per Case Average Scheduled		6,533.35
Per Case Average Filed and Allowed		4,178.38
Difference		2,354.97
Percent of Scheduled Debt		36.04%
Total		
Number of claims filed 323,529	per case	9.22
Number of creditors not filing a claim 172,368	per case	4.91
Claims not included in plan 9,367	per case	.27
Total per Case		14.40

Some persons have suggested that claims should not be filed in Chapter 13 cases on the assumption that debtors would not overstate the amount owed. It should be noted that for these cases alone there are 55,858 unsecured claims filed and allowed for less than they were scheduled by the debtor. The unsecured claims were filed by the creditors or allowed by the court for over $20 million less than the amounts for which they were scheduled. An additional 145,772 creditors never did file claims for unsecured debt which had been scheduled for over $67 million. Some of these apparently

unfiled claims are the result of claims being scheduled by the debtor as due one creditor but the claims were filed by a collection agency or attorney and were not matched up by the trustees.

It should be noted that the entire projected cost of administration including trustee fees, attorney fees and filing fees, etc. to complete all cases is only $46,274,882. This would indicate that these debtors could pay all allowed claims 100% and pay all court costs, attorney fees and the expenses and compensation of the trustee and still be out of pocket $17 million less than they had originally scheduled as owing to unsecured creditors alone. These calculations do not take into account any proposed compromise of debts.

53(23)

53(24)

(53)25

(53) 26

* * * * 1980 * *
MOS. TO 100 %
TOTAL CASES
FUNDS AVAIL.
60 MOS PERCENT AVAIL.
FUNDS AVAIL.
36 MOS PERCENT AVAIL.

(53) 27

TR-900. AS OF 09/81

OVERALL TOTALS

* * * * * * 1980 * * * * * *

Current Status of Active Case
(Includes only chapter 13 cases filed during calendar year 1980 and which were still active on September 11, 1981.)

CASES		PAYMENTS		COSTS TO DATE		COSTS TO PAY FILED CLAIMS		
17,124	SINGLE FILINGS	7549,622.73	MONTHLY PAYMENTS	466,090.93	MISCELLANEOUS	466,565.90		
17,943	JOINT FILINGS	215.29	AVERAGE PER CASE	33RS,752.00	TRUSTEE EXP.	18308,342.18	3485,205.83	UNDISTRIBUTED
35,067	TOTAL FILINGS			3112,795.38	TRUSTEE COMP.	14919,355.45	99.58	AVERAGE PER CASE
		78350,517.21	RECEIPTS TO DATE	18.35	REFEREES EXP.	18.35		
14	AVERAGE MONTHS ACTIVE	2,234.30	AVERAGE PER CASE	9460,074.54	ATTORNEY	12580,590.45		
				16924,736.08	TOTAL	42274,882.33	3507[illegible]44,488.41	TOTAL PAYMENTS
46.4	AVERAGE NUMBER OF MONTHS TO COMPLETE			21.6	PERCENT OF RECEIPTS	13.1	10,002.69	AVERAGE PER CASE

CLAIMS	SECURED	PRIORITY	UNSECURED	OTHER	TOTAL	ATTORNEY
AVERAGE CLAIMS PER CASE	2.78	.39	10.55	.67	14.40	
NOT FILED PAST FILING DATE						
NUMBER OF CLAIMS	17,231	3,857	149,772	5,508	172,368	
SCHEDULED AMOUNT	44882,228.40	3148,872.08	67731,127.68	885,623.42	116667,845.59	
PRINCIPAL PAID	37,893.78	3,254.84	1,717.40	590.00	43,456.02	
NOT FILED UNDER 6 MONTHS						
NUMBER OF CLAIMS						
SCHEDULED AMOUNT	.00	.00	.00	.00	.00	
PRINCIPAL PAID	.00	.00	.00	.00	.00	
FILED CLAIMS						
NUMBER OF CLAIMS	71,807	9,944	224,340	18,236	323,529	35,035
SCHEDULED AMOUNT	184222,765.81	11069,581.82	187322,928.72	7237,645.47	389852,322.32	12956,644.93
CLAIMS FILED FOR AMOUNT GREATER THAN SCHEDULED	16,896	2,359	85,702	940	105,897	
AMOUNT MORE THAN SCHED	11952,112.25-	2308,595.64-	25154,814.54-	743,446.17-	40150,929.92-	
LESS THAN SCHEDULED	27,941	1,647	45,858	562	76,028	
AMOUNT LESS THAN SCHED	49651,598.90	1072,446.47	20988,330.41	799,032.75	72411,408.53	
AMOUNT ALLOWED	146823,279.16	12297,692.31	191589,412.44	7181,445.39	357591,843.71	12580,590.45
PRINCIPAL PAID	36273,313.90	2478,408.46	12833,881.10	3644,922.64	95230,526.58	9460,074.54
INTEREST PAID	2507,725.70	71,529.28	33,682.26	7,012.93	2620,349.27	.00
BALANCE DUE	109132,739.76	9563,017.61	121066,528.62	3301,553.26	243063,835.15	3120,515.91
OUTSIDE						
NUMBER OF CLAIMS	9,068	16	51	1	9,136	
SCHEDULED AMOUNT	47361,846.66	8,781.94	326,377.44	.00	47697,004.16	
PRINCIPAL PAID	45,090.75	206.58	456.08	.00	45,753.41	
REJECTS						
NUMBER OF CLAIMS	214		15		231	
SCHEDULED AMOUNT	1370,076.07	.00	10,519.66	.00	1380,595.73	
PRINCIPAL PAID	494.00	.00	.00	.00	494.00	

(53)28

Senator HEFLIN. Next we have a panel of consumer spokespersons: Mr. Thomas Moore, counsel of the National Consumer Law Center; Ms. Ellen Broadman of the Consumers Union; Prof. Vern Countryman of Harvard Law School, on behalf of the National Bankruptcy Conference; and Prof. Phillip Shuchman of Rutgers University School of Law.

While you are all getting ready, we will take a 2-minute break.

[A brief recess was taken.]

Senator HEFLIN. Who will take the lead? Mr. Moore?

STATEMENT OF THOMAS MOORE, COUNSEL, NATIONAL CONSUMER LAW CENTER, INC., WASHINGTON, D.C.

Mr. MOORE. Mr. Chairman, I am Thomas Moore, staff attorney at the National Consumer Law Center.

We very much appreciate the subcommittee's invitation to testify in the interest of our clients on the bankruptcy law issues raised in this hearing.

Subsequent to the request, we learned of an independent study being completed by Prof. Phillip Shuchman of the Rutgers School of Law in Newark, N.J., and senior law student Thomas L. Rhorer at the University of Connecticut. We knew of Professor Shuchman's scholarly reputation. He is a former deputy director of the 1970 Commission on Bankruptcy Laws.

In lieu of our testimony and by prearrangement with this subcommittee, we ask that Professor Shuchman be allowed to present his findings on the characteristics of persons filing for bankruptcy in the Northeast.

We contend that the subcommittee will want to take a careful look at claims of extensive abuse of the laws created under the reforms of 1978 in the light of our billion-dollar credit economy, and in the light of extensive credit urged on consumers by sellers marketing their products. The 1978 bankruptcy law struck a fair risk-sharing balance among debtors and creditors for the problems that have arisen in this high credit economy. We think that Professor Shuchman's views will have some bearing on that particular contention.

Thank you, Mr. Chairman.

Professor Shuchman?

STATEMENT OF PHILLIP SHUCHMAN, PROFESSOR, RUTGERS UNIVERSITY SCHOOL OF LAW, NEWARK, N.J.

Mr. SHUCHMAN. Thank you, Mr. Moore.

In the interests of brevity, the statement that I have provided is in two parts. If you will look at the second part, you will note that it contains the figures I will use in my present statement.

Preliminarily, it must be said that all of the credit industry had 11 months in which to prepare for the Bankruptcy Reform Act. The bill was signed by the President to take effect 11 months later.

Certainly, most unsecured loans are short term, and any prudent creditor could have adjusted to those. They knew what the law would be, they knew well in advance, and there were numerous dog-and-pony shows all over the country explaining all the implications of the Bankruptcy Reform Act.

As regards secured creditors, they were faced with no problem at all. They knew quite well that they would have a secured claim for the value of their security and that anything else would be a general or unsecured claim.

One could go all the way through the sections of which the consumer credit industry now complains and now fears that it will result in the bankruptcy of the industry. They have said this before. Professor Countryman goes back much longer than I; we have pointed out that their fears that the Republic will fall have been unfounded up to now, I doubt that they are better founded now as regards these sections of the BRA.

As far as what is before this subcommittee, and particularly the suggested compromise to the well-known industry proposal of adding subsection (f) to section 109, that is ambiguous and I think very difficult to determine. All that it does is diminish slightly the completely self-serving aspect which the industry originally proposed. Now all creditors will be treated equally. Previous to this, of course, it was only consumer contractual creditors, which is the industry.

These provisions which go into a reasonable portion of debt, ability to pay, forecasting, and so forth, will generate an amount of litigation that I think will be an almost impossible burden for the bankruptcy judges.

I am surprised that Dr. Johnson is surprised that most bankrupts are employed. We found that out on the Commission. Our present study shows that only 6 or 7 of 123 that we studied in some detail were not employed. Indeed, one precipitating cause of filing a petition in bankruptcy is the actual wage garnishment or the threat of wage garnishment.

I think that these two sections—the two sections which are before this subcommittee, 109(f) and 305(d)—which go to eligibility for chapter 7 and what we should do with those where some think future income might be available, will generate tens of thousands of lawsuits, and the provisions for changes in any order for payment under chapter 13 will generate even more.

Let me take you to what the industry, I gather, prepared—the statement beginning, "Effects of the proposed language." I am impressed with that as a set of biased guesses which, on the whole, omits more of substance than it contains.

In particular, start with prediction 2 which says, "Debtors who can pay some debts out of future income." What this neglects to tell us, again, are the tens of thousands of lawsuits that will be generated when an employed debtor seeks relief under chapter 7.

Since well over nine-tenths of all bankruptcy filers in our sample and in other samples are employed, I think what we will see is routinely filed objections, because of the low cost of doing this, the advantages of the standardized forms, and, I might add, the tax deductibility on the part of these consumer creditors; it becomes a relatively minor matter.

Even with remote chances of success, they have very little to lose by filing these objections, and if they file them on most employed people, you will be facing, and the bankruptcy courts will be facing, hundreds of thousands of lawsuits a year. This is only on the objections to chapter 7.

You might multiply that by those who are compelled by these mandatory provisions to undergo a chapter 13. At that point, again any and all changes involve a court hearing—a full judicial hearing—before a bankruptcy judge of the United States. The most expensive part of the system will be brought to bear on these problems.

As to prediction 4(c) that the limited ability to pay will make creditor objection unlikely because of low potential return, I think I have made clear that I doubt that. Indeed, our past experience—for example, with the so-called fraud exception, which is incorporated in a slightly different way in the Bankruptcy Reform Act—is that in at least 20 percent of the cases, these matters were routinely filed. Understand that when you file one of these, you are accusing someone of a crime. I very much doubt that that portion of the U.S. population is a group of felons.

Prediction 6, which I urge you to look at, is in the form of a statement which is so limited and so artfully stated as to be quite misleading if not simply untrue. The bankruptcy court, the industry tells us, only determines whether the debtor has the ability to pay debt out of future income.

Consider what that means. In this context, that is such a hazard, such a melange of guesses, that it is rather like saying that a jury only decides whether or not an accused is guilty or not of murder or responsible or not for a civil wrong.

The complex of factors that goes into the determination even of the present ability to pay, to say nothing of what is just the fiction of a 2-, 3-, or 5-year prediction of income and expenses, is not a routine activity. At its very best, I would consider it a hazardous guess. In any event, clearly this has got to be done carefully with individual judgments, resulting in adjudication—an order of a Federal court by the bankruptcy judge—once more, the most expensive participant in this entire system.

What these simple proposals before this subcommittee entail is that the bankruptcy courts will function as free official collection agencies. I take it they will have to be ready to enforce their orders by wage garnishment—and that, at the moment, I would consider legally questionable—and, I take it, if that did not work, contempt proceedings, civil or criminal. Ultimately the bankruptcy court may very well have to order that people be imprisoned for failure to comply with an order.

I think that the American people deserve that these proposals, which are self-serving in the extreme, be dismissed out of hand and with alacrity.

I would add that our survey, which, given the limitations of time, I will not set forth in any detail, but which are contained in part 1 of our submitted statement, is not nearly so sanguine as that conducted by Dr. Johnson.

Our debtors were near poor. We took this information from files; we lacked the several hundred thousand dollars that it takes to fund the sort of research that Dr. Johnson did. Their mean and median incomes are both below the Bureau of Labor Statistics' lower living budget. That lower living budget for a family of four in 1979, when our people reported their income—our sample group—

was on the order of $12,700. Our people were earning more than $100 a month less than that.

If you think that one can begin to take 10, 15, 20, or 25 percent out of people like this, I suggest to you that you might be pushing them right to the edge of poverty. These people have unstable incomes; they are mostly employed in marginal activities, mostly on an hourly wage without steady employment; their incomes fluctuate considerably; and even those few that had increases in income showed, in our entire sample, an increase of about 6 percent from 1978 to 1979. During that same period, the Consumer Price Index, which measures cost of living, rose over 14 percent.

In terms of actual buying power, even the best off of our group were worse off in 1979 than they had been in 1978. There are very, very few in our sample that rose even to the BLS intermediate-living budget, which for a family of four at that time in the Northeast region was slightly over $20,000.

I ask you to put yourself in the place of these people and ask what would happen if you had, as they do, uninsured medical expenses. In our sample, the uninsured medical expenses come to roughly 10 percent. This is highest in joint filings.

Senator DOLE. Professor Shuchman, I do not want to interrupt a witness, but we are going to have some time problems here, and your time has expired. I understand Mr. Moore yielded his time.

Let us move on to the other two on the panel, and then perhaps we will have some time for questions.

Ms. Broadman?

STATEMENT OF ELLEN BROADMAN, CONSUMERS UNION, WASHINGTON, D.C.

Ms. BROADMAN. Mr. Chairman and members of the subcommittee, Consumers Union appreciates this opportunity to testify on the proposed amendments to chapter 7.

The proposals drafted could effectively eliminate bankruptcy as a remedy for all practical purposes. Arguably, only the disabled, terminally ill, or elderly could qualify.

Consumers Union strongly opposes the proposed revision. The standards set forth are simply unworkable, arbitrary standards that will be applied differently from court to court, resulting in inequities and an enormous amount of litigation.

The standards being proposed would prohibit people from filing chapter 7 wherever they could pay a reasonable portion of their debt—whatever "reasonable" means—out of all future income, without any deductions for living expenses. Arguably, "reasonable" could be interpreted to be as low as 15, 20, or 25 percent of an individual's debt. It is left totally to the whims and discretion of the bankruptcy court.

A person's entire future income would be looked to in determining whether they could file a chapter 7. It would require very difficult judgment on the part of bankruptcy courts, and it could force consumers to spend a lifetime struggle to meet their debt obligations.

The standard is even more complicated by the fact that there is no exemption for living expenses and no effort to direct the courts that might want to deduct living expenses on how to compute

them. Will different living expenses be allowed for the more well-to-do than the poor, or will all debtors be forced to live on a borderline poverty basis?

Applying the standards will be made virtually impossible by certain developments in the credit market. The introduction of variable rate mortgages and variable rate consumer loans will make it impossible for courts to determine exactly what an individual's future mortgage payment or other debt payments will be. It will be impossible for bankruptcy courts to determine if anyone in the future will be able to meet part or all of their debt obligation.

The standards also will be extremely expensive to administer, since courts will be forced to review individual cases on an ongoing basis. With variable rate mortgages, an individual's monthly payment can jump $100, $200, or $300 a month, which would totally alter their ability to repay their mortgage debt.

The proposal is totally at odds with the philosophy underlying the bankruptcy law of allowing individuals who are overwhelmed by crushing debt obligations to start a new, fresh life without debt burden. It is a philosophy that benefits our society as a whole, that enables individuals to avoid serious emotional, family, personal, and ill-health effects of financial hardship and works to allow them to escape debt burdens, start life fresh, and lead productive, constructive lives.

The proposal would also encourage creditors to engage in improvident credit lending. Creditors would realize that they could string people on indefinitely, they could look to lifetime earnings to repay debt, and they would have virtually no incentive to lend carefully and prudently.

In evaluating this proposal, it is important to look at the changes in the existing credit marketplace. There is an effort afoot now to deregulate or eliminate all State usury ceilings and all State laws that regulate consumer credit charges.

There are also enormous changes occurring in the credit market. Credit is becoming more risky. With variable rate consumer loans and variable rate mortgage loans, consumers may desperately need the relief provided by bankruptcy law when their variable rate mortgage, variable rate auto loans, variable rate home improvement loans, and variable rate credit cards suddenly rise in interest rates.

In closing I would like to stress that Consumers Union does not—and certainly nobody does—like the idea of people who can afford to pay their debt getting out of debt obligation, but we are concerned that the remedy that is being proposed here is far worse than the problem. In today's high risk, high interest, volatile economy, we should not be closing what may be consumers' sole remedy and sole way to escape crushing credit burden.

Thank you.

Senator DOLE. Thank you.

Mr. Countryman?

STATEMENT OF VERN COUNTRYMAN, HARVARD LAW SCHOOL, CAMBRIDGE, MASS., ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

Mr. COUNTRYMAN. Thank you, Mr. Chairman. I appreciate this opportunity to appear before you and testify today. I appear as a representative of the National Bankruptcy Conference of which I am vice chairman.

The proposal you have before you is not new. Essentially, the same idea was proposed to the Congress in 1967, and hearings were held on that proposal before the House Judiciary Committee, after which the proposal failed to emerge from committee.

Almost 50 years ago, in 1932, there was a similar proposal even before we had chapter 13 of the Bankruptcy Act. Then the proposal was to delay granting the debtor's discharge until he paid all or a substantial part of his debt.

I have been in many hearings on bankruptcy legislation—I was not in that one; I was a little too young—and I have read many hearings on bankruptcy legislation. To my knowledge, that proposal in 1932 was the only proposed bankruptcy legislation the witnesses characterized as un-American. That proposal also did not emerge from committee.

It is my position today and that of the National Bankruptcy Conference that the same fate should befall the current proposals.

When I read about Dr. Johnson's press conference earlier this month in news accounts, I wrote to him and asked him if I could have a copy of his study. He kindly sent back to me a stack of tables, graphs, and charts, and advised me that he had no prepared written statement.

I listened therefore to his testimony with great interest. I was particularly interested to hear him say quite distinctly that he did not attempt in his study to predict anybody's future income. I understand why he did not.

Instead, he took their income as it was at the time the petition was filed. Then he compiled some governmental statistics about average living expenses and applied the average living expense figures to the income of the debtors as it was when their petition was filed and extrapolated some conclusions about debtors who file chapter 7 petitions—debtors who, whatever else they may be, are not average.

Mr. Chairman, as I went through that stack of charts, graphs, and tables, I had a feeling I have seen this all before, and I remembered where it was. I had a tour in the Army Air Force during World War II. Whenever higher headquarters would send out to the field requests for information, the information officers would frequently compile graphs, charts, and tables much like the ones I saw here, but they knew what they were doing. They would say, "If you can't get the hard facts, give them eyewash." That is what we have got here.

Apart from my difficulty with Professor Johnson's charts, graphs, and tables, we have four objections to this proposal. We think the charts, graphs, and tables lay no basis for the proposal.

One of our objections is, as a witness said during the similar suspended discharge hearing back in 1932, the current proposals are contrary to the genius of our institutions. The 13th amendment

provides that, except as a punishment for crime, involuntary servitude shall not exist in the United States.

Acting under that amendment, Congress long ago abolished peonage in the United States and made it a crime to hold a person in a condition of peonage. In upholding the constitutionality of those statutes, the Supreme Court defined "peonage" as "a status or condition of compulsory service, based on the indebtedness of the peon to the master. The basal fact is indebtedness."

We would turn our backs on our history and our traditions if we were now to enact a mass peonage statute—which is what this proposal is—whereby the debtor's discharge is to be delayed for a 5-year period of bondage during which his future earnings are sequestered for the benefit of existing creditors.

As some of Senator Heflin's questions have well illustrated, during that 5-year period of bondage the debtor had better retain counsel to help him get adjustments made in his plans so he can get through the vicissitudes of his life during that period. I do not believe that Dr. Johnson's figures included any allowance for counsel fees in what the debtor would be able to pay.

Second, the current proposals, like the ones before them, discriminate against individual noncorporate debtors. There is no proposal that would require the owners of corporations to continue operations for a 5-year period in order to try to produce enough income during that period to pay or reduce corporate debts. But it is only the individual that needs the discharge; corporate stockholders do not, because they are not liable on corporate debts. As someone said before I thought of saying it, "A certificate of incorporation is for stockholders a discharge of debts in advance."

Third, we have used voluntary composition and extension agreements successfully throughout our history in this country, but an involuntary composition or extension agreement forced upon a debtor seeking relief under chapter 7 can be expected to work about as well as compulsory marriage counseling for a spouse bent on separation or divorce. What it will operate as is an incentive for the debtor to quit working so that he can qualify for chapter 7.

Fourth and finally, with the individual debtors before them in individual cases, the bankrupty courts are supposed to decide in each case whether the debtor can pay a reasonable portion of his debts out of his anticipated future income over a 5-year period.

In other words, they are supposed to do what Dr. Johnson declined to do—predict what the debtor's future income will be for a 5-year period. They will get little comfort or help from Dr. Johnson's tables, graphs, and charts in making that estimate, and they will get little help from the testimony of the debtor either.

Debtors, I believe, cannot forecast their income and expenses in any reliable fashion for even a 2-year period, let alone a 5-year period; and I have yet to talk to a bankruptcy judge who believes that he can do a better job of forecasting the debtor's future income and expenses over a 5-year period.

Thank you, Mr. Chairman.

Senator DOLE. Senator Heflin?

Senator HEFLIN. Do you believe that an individual who can pay his or her debts in the future should be committed to discharge their debts; and, if so, why?

Mr. COUNTRYMAN. I do not, because that has always been our concept of the bankruptcy system in this country; it has never been anything else.

The notion was that one of the major purposes of bankruptcy was to free up the debtor's future income to give him a fresh start in life. This proposal before us today is a very revolutionary proposal which would overturn that concept of bankruptcy we have always operated under in this country.

Senator HEFLIN. May I ask you your position in regard to the extension that has been proposed—from 3 years to 5 years—in regard to chapter 13?

Mr. COUNTRYMAN. I would oppose that if it stood alone, Senator. The regimen of living under a budget in a chapter 13 plan is a very rigorous one, not only for the debtor, but for his entire family. To almost double that period from 3 years to 5 is to impose on the entire family an insufferable burden, in my judgment.

Senator HEFLIN. If this concept of future earnings were to be adopted, are there certain provisions that ought to be provided in the legislation that you would see as necessary?

Mr. COUNTRYMAN. In my written statement I call attention to what may only be a technical error, but the proposals as they now are would exclude from chapter 7 a lot of people who are not eligible for chapter 13 because their debts exceed the limits now fixed in section 109(e). I would think that something would certainly have to be done about that.

Also, there are going to have to be transition provisions for some of the cases you hypothesized, where the debtor simply cannot hack the 13 plan. I do not see that any attention has been paid in the proposed legislation to that problem either. I would like to repeat that I think we would make a serious error to adopt this proposal.

Ms. BROADMAN. I would like to address that question too, if I might.

I think there is an inherent problem with trying to use future income as a factor in bankruptcy in that it is so uncertain. You are creating a system that is going to be very expensive to administer because of the uncertainty, the income changes that will occur over each individual's lifetime, or if you use the cutoff period, during that cutoff period. So you are creating a very expensive system to administer.

In looking at this proposal, I wonder if someone went in there and studied the expense of administering one of these systems—if it might be more expensive than the funds that are being lost by creditors, and if the true wealth transfer would not be one from the taxpayers who have to pay for the bankruptcy court to the creditors who are recovering their debts.

If the committee were to go ahead with trying to use future income as the measure—which we feel is ill advised—at a minimum you should define with great precision what a reasonable percentage of the debt is; there should be a very short cutoff period—say, 2 years or 3 years—and a very generous living standard; and there should be a standard one applied for all debtors who are trying to seek bankruptcy relief.

Senator HEFLIN. Mr. Chairman, of course decisions have not been made and everybody is trying to keep an open mind on these

various models, but it seems to me that it might be appropriate for people in pro and con positions on this—if they wanted to draft some type of legislation or specifically point out certain provisions that ought to be included in legislation if it were to be adopted, it would be helpful to the subcommittee.

If you have no objection, I would like to invite language that could be used in the legislation from both sides.

That does not mean that any decision has been made one way or another, but I think it would be helpful in an evaluation, since there is no bill or real legislation before the subcommittee.

Senator DOLE. If in fact they are willing to do that, we would be happy to have the information.

I understand the disagreements are rather distinct. There may not be any room for compromise. But if there is, we are pretty good at that sometimes. It may not appear that way after we have passed the law, but there are changes made from time to time. We would like to have your input.

I know that this panel believes that we just ought to end the hearing now and say we are not going to do anything. And maybe that is what will happen. I am not suggesting how this subcommittee will vote, how the full committee will vote, how the Senate might vote, or what is happening in the House.

If you assume from your standpoint the worst of something may happen, then I think it might be in your interest to submit to us some ideas so that at least we have, as Ellen indicated, some definitions or standards that we may need to write into the law. We would be very happy to have that information.

Mr. Moore, do you have any comments you want to make? I do not want to cut anyone off?

Mr. MOORE. I introduced Professor Shuchman. He testified in lieu of testimony that would have come from the National Consumer Law Center. I am sure he would like to complete his summation of written testimony.

Senator DOLE. I see. I have read a summary of his statement. I did not read his 100-page statement.

Mr. SHUCHMAN. I urge you to do so.

Senator DOLE. I may be able to do that this weekend. I am going to Kansas. Maybe I can read it on the way, or something.

I think it is a good idea, Senator Heflin.

Thank you very much.

[The joint statement of Professor Shuchman and Mr. Rhorer and prepared statements of Ms. Broadman and Professor Countryman follow:]

Prepared Statement of Phillip Shuchman and Thomas L. Rhorer

The numbers and the per capita frequency of personal bankruptcy filings have, with but a few short exceptions, been generally and consistently increasing since shortly after the Second World War. The increases have been discussed in the professional literature and been the subject of comment in newspapers on several occasions over the past 20 years.[1] Indeed, the primary motivation for the creation in 1970 of the Commission on the Bankruptcy Laws of the United States was Congressional concern over the rising number of personal bankruptcy filings, in particular, the increase by more than 1000% from 1950 to 1970.[2]

Despite the considerable and apparently continued increase in personal bankruptcy filings, consumer credit has also continued to rise in nearly all categories, including credit cards and mobile home credit. At the end of August, 1981, consumer installment credit debt totaled $324.65 billion, an increase of 6.2% from one year earlier.[3]

On October 1, 1979, the Bankruptcy Reform Act of 1978 (BRA) became law. About the same time as the BRA became effective, the cyclical but overall steady growth of personal bankruptcies began to rise sharply. Many creditor groups attributed the increase largely to the availability of expanded federal exemptions. Alarm brought quick calls for reform of the Reform Act, despite the presence of a number of other factors which would also have increased the number of bankruptcy filings. It is necessary to take into account the general deterioration of economic conditions (primarily the sustained high levels of unemployment and underemployment, continued inflation and very high interest rates),[3A] the growth of

1. For example, the New York Times of October 12, 1975 (Section 3, page 1) reported the concern of creditors and their lawyers that bankruptcy was becoming too easy to file. "Overall, more than 250,000 bankruptcies were filed in the 12 months ended June 30 (1975) -- an increase of one-third over the year earlier level."

2. Report of the Commission on the Bankruptcy Laws of the U.S. (1973) Part I, page 1.

3. Wall Street Journal, October 8, 1981 at page 6 (citing Federal Reserve Board data).

3A. The already severe financial circumstances of the typical debtor in a non-business personal bankruptcy is getting worse. One (Continued)

lawyer advertising (including the easier entry of new lawyers into a field that had been a fairly well closed shop), the increased public awareness of bankruptcy, and an apparent loss of whatever social stigma once accompanied bankruptcy. But the Bankruptcy Reform Act itself has become the center of the controversy.

The debate proceeds with little published empirical foundation except for the experiences of interested credit business firms and anecdotal evidence. All that has been available in the first eighteen months of the Bankruptcy Code (as the BRA became known upon enactment) is a rough headcount indicating a rising population of bankruptcies. Although trends and projections can be drawn from these figures, the causes of the increase in filings are largely conjectural.

One last minute compromise, perhaps the major threat to the uniformity sought for in the Reform Act, was the provision in § 522(b)(1) allowing states to "opt out" of the federal system of exemptions established in the same section.[4] The fact that something could be done at the state level led to something being done. The tendency in some states (where "opt out" legislation has been debated) seems to be to act on speculation rather than to obtain data on the operations of the BRA and then to study and deliberate before taking legislative action. Some thirty-two states have "opted out" of the federal exemptions.[4A] The effect is yet to be seen. We have no reliable indications of whether these state actions have curbed the rise of bankruptcies in those states. Preliminary indications, e.g., the increase of filings in states in which the federal

(Continued)
can infer this from the fact that unemployment is still rising, having increased from 7.2% in August, 1981 to 7.5% in September, 1981. The number of jobless workers increased from 7.7 million to 8 million in that same one month. (N.Y. Times, Oct. 21, 1981 at page D2.) (If we added some 366,000 workers who dropped out of the labor force -- most simply gave up and stopped looking -- the unemployment rate would be 7.8%.) Also, new claims for unemployment insurance are now running at the rate of more than half a million a week. (Bus. Week, Oct. 26, 1981 at page 51.)

4. The "opt out" survived a challenge to its constitutionality based on the apparent requirement of uniformity in the language of Article 1, Section 8. In re Sullivan (1981, CDIL), 11 BR 432, 4 CBC 2d 577.

4A. Most have, however, at the same time, revised their state exemption laws -- many for the first time in 50 years or more -- making them more generous to debtors and more suited to the times.

77(2)

exemptions should have had little impact, because the state exemptions available before the reform were more generous than the federal exemptions, are that the increase in filings occurred independently of the new exemptions.[5] Even in states such as Connecticut, where the federal exemptions represented a major change, the figures are also ambiguous. Despite the new federal homestead exemption of $7,500 per debtor in a state which has no homestead exemption, Connecticut, in fact, had less of an increase in filings than did the Nation as a whole.[6]

The claim that the more generous federal exemptions "caused" the increase in personal bankruptcy filings by, as the expression goes, "making bankruptcy more attractive," suggests that the numbers of business bankruptcies should be compared, for in business bankruptcies the exemption laws have no application. For the first 11 months of 1980, the increase in business bankruptcy filings (excluding personal bankruptcies due to or related to small business failures) was some 52% more than the same 11 months in 1979. Since personal exemptions are not applicable to business filings, this increase is wholly independent of the change in the exemption law. The debts of these failing businesses were vastly larger: about $4.3 billion in the 1980 period as compared to $2.5 billion for those 11 months in 1979.[7] And in the first few months of 1981 business bankruptcy filings increased by an additional 63% from the comparable period of 1980 and reached the highest number of filings since 1963.[8]

The gross figures obviously must be supplemented by more detailed studies if the impact of the Bankruptcy Code on the number of filings is to be assayed well enough for proper congressional action. We undertook a simple descriptive statistical investigation resulting in this study which must be considered both exploratory and preliminary: exploratory because we began at the opposite pole from the gross headcounts in part to determine what reliable in-

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5. See attached Tables A-C, supplied by Christopher N. Giuliana, Esq.
6. Ibid.
7. N.Y. Times, March 30, 1980, page A7 (from data provided by Dunn & Bradstreet, Inc.).
8. Id.

77(3)

formation could be gleaned from the petitions of individual bankrupt debtors; and preliminary because we were looking for whether the effects of the new Code provisions could be seen in the individual petitions and for how those effects could be analyzed. For reasons of convenience and lack of funding, we took a relatively small sample in a small state, but large enough, we think, to be reasonably confident of gross variations we found. Our conclusions, therefore, although saying some things about the correlates (and perhaps the causes) of bankruptcy and the composition of the population of bankrupts under the Code, also go to the complexity of the problem of analyzing trends in bankruptcy.

Connecticut, and in particular the bankruptcy venue for the court sitting at Hartford, the source of our samples, has a fairly diverse population and economy. Six of Connecticut's eight counties, including 117 of the state's 169 townships, are within the venue of the Hartford Court. Our samples include detailed information on cases from 49 of those towns. The highest concentrations of these cases came from the urban industrial areas of Hartford, Bristol, New Britain, Meriden, and Groton, but largely rural towns of Windham and Tolland counties were also represented among the cases. The debtors, similar to those in past studies,[9] were mostly engaged in unskilled to semi-skilled occupations that are related to the armament, service, and construction industries. But there were also some agricultural workers and other debtors having occupations more suitable to a rural economy in our samples. This broad base of sources for petitions, combined with the radical change in Connecticut's exemption laws brought about by the introduction of a $7,500 per debtor homestead exemption, or its equivalent value in other property, makes Connecticut a good place to look for changes in bankruptcy filing patterns. For a researcher familiar with the existing Connecticut exemptions under Conn. Gen. Stats. § 52-352 et seq., those petitions claiming more under the new federal exemptions than would have been allowed under existing state exemptions are identified as cases in which the decision to file

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9. Shuchman, Little Bankruptcies in New England, 56 Bost. Univ. Law Rev. 685 (1976).

was at least made less onerous by reason of the more generous federal exemption law.

Note again that there is no state homestead exemption under Connecticut law. The Bankruptcy Code allows a family (with both husband and wife filing) an exemption of some $15,000 in real estate equity in their family residence. Equally important is that only the federal exemption law allows the debtors (bankrupts) to apply the unused portion of the $7,500 per person homestead exemption to any other personal property. This is termed the "spillover" right.[10]

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10. Matter of Smith, 640 F.2d 888, 7 BCD 419 (7th Cir., 1981), stands for the proposition that the words any property in 11 U.S.C. § 522(d)(5) mean indeed any property and do not limit the debtor to other property enumerated in § 522(d).

STATE	Bankruptcy Filing Rate Per 1,000 1978-79	State Ranking (Highest to Lowest)		Bankruptcy Filing Rate Per 1,000 1979-80	State Ranking (Highest to Lowest)	
ALABAMA*	2.07	1		3.10	4	
TENNESSEE*	2.04	2		3.64	1	
IDAHO	2.01	3		3.49	3	
NEVADA	1.96	4		3.56	2	
INDIANA*	1.82	5		3.03	5	
KANSAS*	1.75	6		2.69	9	
ILLINOIS*	1.62	7		2.93	8	
GEORGIA*	1.58	8		2.39	16	
VIRGINIA*	1.55	9		2.14	17	
KENTUCKY*	1.53	10		2.96	7	

10 States which foreclosed Federal exemptions.

TABLE A

COMPARISON OF BANKRUPTCY FILINGS PER THOUSAND:
Experience of Top Ten Pre-Code States in
1978-79 and 1979-80.

STATE	Homestead Exemption	Bankruptcy Filing Rate Per 1,000 1978-79	State Ranking (Highest to Lowest)		Bankruptcy Filing Rate Per 1,000 1979-80	State Ranking (Highest to Lowest)	
N. DAKOTA	$80,000	.94	27		1.19	37	
NEVADA	50,000	1.96	4		3.56	2	
MASSACHUSETTS	50,000	.45	46		.66	49	
CALIFORNIA	45,000	1.48	13		2.45	14	
MISSISSIPPE	30,000	1.12	22		2.10	20	
HAWAII	30,000	.63	39		1.08	40	
IDAHO	25,000	2.01	3		3.49	3	
WISCONSIN	25,000	.89	31		1.38	35	
WASHINGTON	20,000	1.28	18		2.56	13	
MONTANA	20,000	1.15	20		1.87	22	
ARIZONA	20,000	1.38	17		2.13	18	

TABLE B

COMPARISON OF BANKRUPTCY FILINGS PER THOUSAND:
Experience of 11 States with high homestead exemptions in 1978-79 and 1979-80.

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TABLE C

COMPARISON OF NUMBER OF BANKRUPTCY FILINGS
BETWEEN THE TWELVE-MONTH PERIOD ENDING SEPTEMBER 30, 1979 AND
THE TWELVE-MONTH PERIOD ENDING SEPTEMBER 30, 1980*

State	Bankruptcy rate per 1,000 1978-79		Bankruptcy rate per 1,000 1979-80			
	Rate per 1,000 1978-79	Ranking (ranked from highest to lowest)	Rate per 1,000 1979-80	Ranking (ranked from highest to lowest)	Percentage increase	Ranking (ranked from highest increase to lowest)
Alabama	2.07	1	3.10	4	49.6	40
Alaska	1.08	23	1.59	27	47.7	41
Arizona	1.38	17	2.13	18	54.3	37
Arkansas	.93	29	1.54	30	66.0	30
California	1.48	13	2.43	14	63.9	31
Colorado	1.43	15	2.63	11	83.2	18
Connecticut	.65	38	.88	44	35.3	46
Delaware	.51	43	1.02	42	100.6	9
Florida	.60	40	.78	46	28.3	49
Georgia	1.38	8	2.39	16	51.7	39
Hawaii	.63	39	1.08	40	73.0	27
Idaho	2.01	3	3.49	3	73.5	26
Illinois	1.62	7	2.93	8	80.9	20
Indiana	1.82	5	3.03	5	66.4	29
Iowa	1.03	26	1.78	25	73.6	25
Kansas	1.73	6	2.69	9	54.1	38
Kentucky	1.53	10	2.96	7	94.2	13
Louisiana	1.21	19	1.58	29	31.4	48
Maine	.94	27	1.26	36	34.6	47
Maryland	.56	42	1.14	38	102.8	7
Massachusetts	.45	46	.66	49	47.4	42
Michigan	.87	32	1.79	24	106.6	5
Minnesota	.92	30	1.57	29	70.6	28
Mississippi	1.12	22	2.10	20	87.3	16
Missouri	1.08	23	2.02	21	87.3	16
Montana	1.15	20	1.87	22	63.1	33
Nebraska	1.38	16	2.60	12	88.9	15
Nevada	1.96	4	3.56	2	81.6	19
New Hampshire	.59	41	1.06	41	80.9	20
New Jersey	.46	45	.91	43	98.3	12
New Mexico	1.13	21	1.63	26	43.9	44
New York	.73	36	1.50	31	99.6	11
North Carolina	.82	34	1.80	23	120.2	4
North Dakota	.94	27	1.19	37	26.1	50
Ohio	1.31	11	3.03	5	100.8	8
Oklahoma	1.46	14	2.12	19	44.7	43
Oregon	1.31	11	2.66	10	76.2	24
Pennsylvania	.41	48	.84	45	103.4	6
Eastern District	.48	—	.87	—	82.0	—
Middle District	.43	—	.81	—	86.4	—
Western District	.33	—	.84	—	154.0	—
Rhode Island	.48	44	1.40	34	194.7	1
South Carolina	.17	50	.42	50	144.3	3
South Dakota	.80	35	1.43	32	80.9	20
Tennessee	2.04	2	3.64	1	78.1	23
Texas	.40	49	.76	47	90.4	14
Utah	1.08	23	2.44	15	125.4	3
Vermont	.44	47	.70	48	58.9	35
Virginia	1.55	9	2.14	17	38.0	45
Washington	1.28	18	2.56	13	100.5	10
West Virginia	.70	37	1.13	39	61.6	34
Wisconsin	.89	31	1.38	35	55.3	36
Wyoming	.87	32	1.44	33	64.5	32

*Note that the Bankruptcy Code became effective Octr 1, 1979. This table was compiled from data supplied to the Joint State Governmer ission by the Administrative

77(8)

B. The Connecticut Cases

Our samples include 461 non-business personal bankruptcy filings and 67 more personal bankruptcy filings which, from the schedules, we could determine were related to or the result of a concomitant small business failures. The two questions upon which we first focus are the subject of much disagreement, but so far, because few data have been published, have been argued inconclusively:

(1) Can we assay the dollar impact of the more generous federal exemptions upon unsecured creditors in Connecticut, a state with very limited exemptions and without any homestead exemption at all?

(2) How ought the researcher and the legislator calculate joint petitions (not previously permitted but allowed since October, 1979 under § 302 of the Code)? Are the joint petitions of spouses best taken as two separate cases for purposes of calculating the increase in personal bankruptcy filings? Are there more appropriate factors to be considered, such as an increase in the unencumbered assets (those which could be liquidated for the benefit of unsecured creditors) in the joint petitions as compared with those of individual petitioners? Is the mean of unsecured debt for both individual and joint petitions a more accurate measure of the impact on unsecured creditors?

We analyzed in fair detail a systematic random sample of 128 [see Appendix A] personal bankruptcy filings, representing approximately every tenth personal bankruptcy filed in the Bankruptcy Court at Hartford during 1980. We found significant differences in the type of debt, not only between business-related and non-business petitions and between individual and joint filings, but also between male and female debtors. We were able to isolate those cases[0] in which the debtors used the federal exemptions to protect property

0. Although we were as specific as the schedules allowed, we found the specification of property claimed as exempt to be feasible only by general category. We used the general categories of §522(d) to list the value of equity in real property, equity in automobiles, aggregate value of household goods, clothing and jewelry, cash surrender values of life insurance policies, claimed values of pension plans and other retirement rights, tools of the debtor's trade, and tort claims for personal injury. We were able to identify those items of property that could not have been claimed as exempt under

(Continued)

which could not have been protected under Connecticut statutes. In only 28 of the larger sample of 461 cases not having business involvements (6%) did the more generous federal exemption law make any difference to the unsecured creditors. Most of those cases (22 of the 28 or 5% of the 461 cases) involve real estate equity as the major basis for the difference in impact between the federal and the Connecticut state exemption laws. For all 28 cases, the mean (arithmetic average) loss to the unsecured creditors due to the federal exemption provisions is $6,679, while the mean unsecured debt per case is $13,628. Thus, freely speaking, in about one case in 16 (the 6% frequency) unsecured creditors potentially lost about half their claims (49%), some of which would have been paid to them under the existing Connecticut law. (Table D)

(Continued)
present Connecticut law, or by other federal statute. From that foundation, we were able to estimate the potential loss to creditors in each case by adding the values of the pieces of property that could not have been exempted without recourse to the federal exemptions and, by deducting the value of priority claims, we could arrive at the potential loss to unsecured creditors before administrative expenses.

TABLE D

Funds Hypothetically Available to Unsecured Creditors,
Had the Petitioners Been Restricted to Present State Exemptions
(Non-Business Cases Only; Cases Out of a Total Sample of 461)

	Number of Cases	% of Total Sample ($\frac{X}{461}$)	Mean of Unsecured Debt	Mean of Hypothetical Dividend to Unsecured Creditors	Hypothetical Dividend as % Unsecured Debt
All non-business cases with significant assets	28	6.1%	$13,628	$6,679	51%
Cases in which real estate equity is the major significant asset	22	4.8%	$14,340	$7,714	54%
Cases with significant assets other than real property	6	1.3%	$11,020	$2,884	26%

77(11)

Equity in real estate makes the difference in the majority of these cases (22 of the 28 "asset" cases are that only because of the fact of home ownership). Real estate equity is defined as market value[1] given in the bankruptcy schedules less all mortgages of record more than 90 days prior to the filing date.[2] In these 22 of 28 cases the mean loss to the unsecured creditors due to the federal exemption provisions is $7,714 while the mean unsecured debt is $14,340. Thus, in these five percent (5%) of all the cases, those creditors lost slightly more than half their claims (54%). Nearly two-thirds of all these "asset" cases are joint petitions (18 of the 28 and 14 of the 22 largely real estate equity cases).

We have calculated all equity (real estate and other property) by deducting the priority claims under § 507 such as tax claims, state welfare liens and obligations for the support of spouse and children under § 523(a)(5). One must deduct from this hypothesized "gross" equity, the costs of foreclosure sale, whether public or private, or by auction or negotiated sale through an agent or broker. In that regard, it is almost always true that foreclosure through the bankruptcy court is more expensive than under state law. The additional legal formalities add costs, and the fees which must be paid to the trustee will make the net proceeds (the realized equity) less in the bankruptcy setting. The trustee's fee on $7,714 will be about $410[3] (or 5% of the "equity") in addition to the usual commissions (about 6% of the sale price, not merely of the equity) paid in a private or public auction sale (§ 327). And given the median real property market value from our sample of $40,000, that commission is on the order of $2,400, so after fees and commissions,

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1. Although for purposes of deciding whether a lien was an unlawful preference, a bankruptcy court recently held that "market value" was not the same as liquidation value. The opinion is based on the court's interpretation of § 522(a)(2). In re Nellis, 7 Conn. Law Tribune, September 14, 1981.

2. We found none within 90 days, which would have been a transfer voidable by the trustee under § 547.

3. From Code § 326, the limitation on the trustee's compensation is

15% of the first	$1,000 =	$150
6% of the next	$2,000 =	$120
3% of the balance of	$4,714 =	$140
	$7,714	$410

77(12)

the liquidated real property value left for creditors is about $4,904.

A modest homestead exemption under state law would, at this time, leave nothing for the unsecured creditors. The $10,000 New York homestead exemption[4] would eliminate virtually all dividends. Even assuming single person ownership (and most are joint petitions with joint ownership) the $7,500 federal exemption would permit nearly all these debtors to retain the small amount of equity they have in their homes.

The six (6) other non-real estate cases in which the Connecticut state exemption law would have helped the unsecured creditors are much smaller and result in a mean loss to unsecured creditors per case of about $2,884 (about 26% of the mean unsecured debt of $11,020) given the available choice of the federal exemption law and positing an unchanged Connecticut state exemption statute.

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4. N.Y. C.P.L.R. § 5206(a).

C. The "Typical" Non-Business Debtors

We can form a tentative composite portrait of the typical non-business debtor from the 107 cases we examined in detail and which we determined to be unrelated to business debt. For convenience, we have designated these 107 cases as Group A. [See Appendix A.] Bankruptcy is still primarily a remedy for persons of modest income, doing unskilled or semi-skilled work. About a third of the males listed occupations which could fall into the general category of factory work, with mechanics, truck drivers and building tradesmen making up the next largest groups, and the remainder scattered among restaurant work, sales, maintenance, warehousing, and office work. Female debtors listed clerical occupations most often, and the rest were employed in factory work, retail sales, unskilled service work (e.g., nurses' aides), food service work, teaching and factory work.

Group A (N=107) Mean Incomes[1]	Medians
Mean income in 1979 for Group A as a whole was $11,744	($11,000)
For males filing individual petitions, $10,809	($11,000)
For females filing individual petitions, $9,703	($ 9,000)
For joint petitions showing only one income, $12,793	($11,600)
And for joint petitions showing two incomes, $17,619	($16,000)

In comparison, the median income for all Northeast Region households in 1979 was $20,622.[1a]

The highest family incomes were for joint debtors with two incomes which amounted to about 85% of the 1979 median income for the Northeast Region measured by the Bureau of Labor Statistics (BLS). For all other groups the 1979 range was from less than half the median income (females at about 47%) to about 60% (joint petitions with one income).

Half of those files showing income for both preceding calendar years reported an increase in income. In most cases, the increase

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1. The range of incomes in our sample is much narrower than for a sample of all persons or households. Hence, the means are apt to be more descriptive (and our medians are close to the means in all our groups and for the entire sample).

1a. Money Income and Poverty Status . . . (1980) Bureau of the Census, Series P-60, No. 127 (1981).

77(14)

was modest and less than the rise in the Consumer Price Index. The larger increases appear to be the result of steady employment during 1979 following underemployment during 1978, or the entry of a previously unemployed spouse into the labor force. Twenty percent of the group reporting incomes for both years showed declining income, and the remainder stayed about the same. Only six reported being unemployed at the time of filing. The increases for those with rising incomes, however, served to raise the mean income for Group A only 7.3% in 1979.[1B] Fluctuations of income in an unstable economy and high rates of inflation are factors in the rate of bankruptcy filings, but the individual petitions themselves say little about macro-economic influences.

The economic pressures on the debtor families is indicated by the frequency and type of lawsuits. Group A debtors had been involved as defendants in civil actions in 49 of the cases (46%). A third of those debtors were involved in multiple lawsuits. Slightly over half (33 of 62) of all the reported lawsuits involved consumer credit, and another quarter were suits seeking to recover unpaid medical expenses. The remaining suits were either divorces or conventional tort actions. Eighteen of the debtors (17%) had had his or her wages attached by judgment creditors and one had his wages taken by IRS levy. An additional nine debtors (8%) had lost cars by repossession, or homes (including mobile homes) to foreclosure within the last year.

The average debtor in Group A owed thirteen creditors holding unsecured claims a total of $8,732,[2] and had a total outstanding debt, including secured claims, of $10,663. This total debt is a little over five times the assets claimed by the average debtor

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1B. Which means they had less purchasing power because the CPI cost of living measure rose by 14.3% from June, 1979 to June, 1980. Fed. Res. Monthly Bulletin (Aug. 1981) Table A-49 (using BLS data as the source).

2. The highest number of creditors in any case in Group A was 57; the lowest was 1, which occurred in two cases, one involving a tort, the other a single, large hospital bill.

($2,053). This is about 90% of the average 1979 income for Group A ($11,744).[3]

The average debtor used credit for a variety of sources, but relied most heavily on credit from merchants and major credit cards. Of all the cases in this group, 79% listed retail merchants among their creditors having unsecured claims (with a mean of 4.5 merchants per case), and 63% listed credit card debt (1.4 cards per case). Somewhat more than half (53%) had debts owing to finance companies. These three sources of credit are to be expected for the income level of persons making up this group. Credit cards and finance companies[4] are both common sources of money on relatively easy terms, but at high interest rates. Retail merchants in Connecticut have competed for the same market by issuing in-house credit cards. Credit unions, although less often used as sources of credit by the debtors, are still listed in more than a third of the petitions (37%);[5] closed-ended loans (for a specific amount determined at the time of transaction) from commercial banks appeared in almost half of the cases (46%). The pattern of borrowing varied considerably between male and female debtors, and between individual and joint filings. We discuss some of these variations below.

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3. Comparisons between annual income and gross unsecured debt are not reliable or particularly useful. Debt is generally incurred over a period of years and repayments are planned to fit disposable income, which varies considerably with factors not available to us in the files, e.g., family size. However, the consumer finance industry has been arguing that bankruptcy law, with its structure of protecting assets through exemptions, is out of step with lending practices that look to future income for repayment. Therefore, we have included income figures for comparison with debt burden for whatever value they may have. Taking into account the factor that much of the general class of debtors is victim to wide fluctuations in income due to the instability of the job market for unskilled labor, with some trepidation one could take the debt burden and estimate the proportion of income it would take to amortize the debt burden over three to five years (a process similar to testing the feasibility of a Chapter 13 plan). From this sort of analysis, it can be shown that the average case would have a difficult time arranging any kind of payment plan.

4. One aspect of the data raises a serious question regarding the common presumption that finance companies are the exclusive source of credit for the near-poor high-risk borrower: only six of the 57 cases showing debts to finance companies had no debts to the other categories of cash lenders. These six had a mean income of $16,323, and the debt to finance companies accounted for 45% of their total unsecured debt.

5. Credit unions may lay claim to being the source of cash credit for the poorest of the debtors. Three out of 34 cases involving credit unions had no other commercial lenders as creditors.

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The remaining class of major debt may have much more to do with the causes of bankruptcy. Over two-thirds of the cases in Group A (68%) listed medically related debt, and medical debts accounted for 10% ($94,837) of the total of all unsecured debt in Group A (and 8% of all credit). While not alarming in the context of the percentages of each of the other types of debt as a portion of the debt (Table E), when it is considered that medical debt is both commonly involuntary and is not tailored to fit the anticipated future income of the debtor, it can be seen that the addition of an unexpected 8-10% to the debt burden of a debtor in this class can be catastrophic.[6] Sex-based variations, discussed below, suggest that medical debt may be a more serious influence on the national increase in filings than some other studies have suggested.[7]

Of the miscellaneous additional classes of debts we examined, only student loans stand out as having any potential significance. Of the fourteen cases (13% of Group A) involving student loans, six cases, accounting for about 60% of the total outstanding student loan debt (which is about 2% of total unsecured debt), were clearly dischargeable on age alone.[8]

Modest incomes for Group A were matched by their minimal assets. The average debtor owned one automobile ($592 equity in

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6. If lending patterns fit those described in testimony, concerning the lending practices of high-risk lenders delivered by David H. Williams, staff attorney for the Federal Trade Commission during the hearings on H.R. 31 and H.R. 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, 94th Cong., 1st and 2d Session, ser. 27, pt. 2 at 758-63, reprinted as Appendix 1 of House Rep. 95-595, a ten percent unexpected debt burden from medical expenses could account for a major proportion of the bankruptcy losses suffered by high-risk lenders. Williams reported a pattern of lending to extend credit on the basis of disposable income above what was needed for basic subsistence, such that the customer's disposable or marginal income was wholly committed to credit service.

7. We have not seen, among the comparisons of the rising number of bankruptcies with the rising costs of consumer needs, a comparison with the rising costs of medical care which have been increasing more than the C.P.I. cost of living index.

8. Student loans guaranteed by governmental units are non-dischargeable unless over five years old, or if the debtor can show that excepting the debt from discharge would work an undue hardship on his or her dependents. 11 U.S.C. 523(a)(8) as amended. Two cases involved uninsured motor vehicle accidents, and appeared to have been filed solely to avoid the consequences of Connecticut's financial responsibility law which requires the posting of a cash bond or license suspension if tort claims are pending. Two other cases involved child support assigned to the state, representing only $5,900, a fraction of one percent of the total debt for the group.

one automobile] and claimed to have $1,048 worth of household goods, furnishings, and clothing. Nine percent scheduled no household property at all, and almost one-quarter (26 of 107) had no interest in a motor vehicle.[9] Only two automobiles of the 81 appeared to have exceeded the state $1,500 equity exemption, and one individual debtor owned a second car that could not have been exempted without the "spillover" exemption in 522(d)(5).[10] Yet the small values in automobiles and household goods accounted for two-thirds of the total assets owned by Group A. The next largest category of asset was made up of estimated tax refunds, which although a more speculative figure than the others, may well approach 8% of the total listed assets. Tools of the debtor's trade were exempted in nine cases, but represented only 3% of the total assets. The remaining assets were in the form of cash. In 40% of the cases (averaging $93 per case), this "cash" was in the form of wages taken by wage execution in the 90 days preceding the filing (11 cases, at a mean of $434 per case), and cash surrender values of life insurance policies (5 cases; mean of $1,175).[11] Miscellaneous items of little value included dogs, guns and boats, and three small tort claims, two of which were deemed in the petitions to be "uncollectable."

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9. We counted those claiming an exemption for a motor vehicle, yet showing no equity in it in their schedules as having a nominal interest in a motor vehicle, at least an interest in maintaining possession, although that interest may have no monetary value. Cf. In re Pickus, 7 BCD 189 (BC CT 1980).

10. In re Smith, 640 F.2d 888 (7th Cir., 1981).

11. One case claimed a large profit-sharing retirement plan, ($12,413) which, to be conservative, we included in the total of assets for the group, but it was determined to be wholly exempt property under federal statutes other than the Bankruptcy Code, as well as under 522(d)(10(E), so we did not count it as an asset available to creditors absent the exemptions of 522(d). Cf. In re Hurd (B.C. Conn. CCH Pension Rptr. 22,735.) Cash surrender values of life insurance policies are exempt under Connecticut insurance statutes. Pearl v. Goldberg, 300 F.2d 612 (2d Cir. 1972).

TABLE E

Percentage of cases of each subgroup of
Group A having unsecured debts in each category

	Medical	Banks	Credit Cards	Merchants	Credit Unions	Finance Companies
Joint	82%	53%	59%	81%	34%	72%
Male	60%	51%	69%	77%	40%	54%
Female	72%	41%	62%	86%	28%	45%
All Group A	68%	46%	63%	79%	37%	53%

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D. Joint Petitions

Joint petitions, first allowed after October 1, 1979, under Code § 302, present a complex problem in comparing numbers of pre-Code filings with numbers of post-Code filings. The gross number of filings under the Code probably should be increased by a factor representing that proportion of joint petitions which would have been filed as separate individual petitions by spouses, had the joint petition not been possible. The simplest way to treat this factor is to assume that every joint filing now would have been two petitions. The adjusted number of Code filings which corresponds to the numbers of actual cases filed before October 1, 1979, is then derived by doubling the number of joint filings and adding that sum to the number of individual filings. This method is likely to be misleading. A joint case can be prepared and filed at little extra cost to the debtor. The filing fee remains $60, so the only additional cost is $50 to $75 in legal fees to prepare an additional set of statements and schedules.[1]

More serious errors are likely to occur if it is assumed that the dollar impact of joint petitions is proportional to the number of filings. If the joint filing couple had only one income, the amount of credit likely to have been extended under standard lending practices is probably little different than the amount available to the wage earner if he (probably not she) were single and had the same income. Thus, the loss to the creditors in joint petitions is not likely to be doubled. We sought to test the assumption, and in the process discovered strong variations in debt patterns between male and female filings and between individual and joint cases. An adequate model for comparing recent bankruptcies with bankruptcies over the last decade, we suggest, must not only take these apparent variations in borrowing patterns into account, but must also find a

1. Local Rule 8 in the District of Connecticut requires that separate statements and schedules be filed in each joint case. The rule is seldom followed, however, and often a joint petition is accompanied by a single set of forms in which only questions 1 and 2 of the Statement of Affairs contain different answers for the husband and wife.

factor for what we think is a substantial increase in the number of female bankrupts.

The Administrator of Federal Courts has been keeping count of the number of joint filings since the Code took effect. During the last reporting period (the year ending March 31, 1981) the Administrator's figures show joint filings to be 43% of the voluntary non-business Chapter 7 filings in the Nation and 32% of the cases of the same kind in Connecticut.[2] Our sample agrees well with the Administrator's figure for the District of Connecticut. We found 135 joint petitions in 461 non-business cases (29%).[3]

Counting joint petitions as two filings, the total number of cases filed in the District of Connecticut increased by about one-third after the effective date of the BRA. Positing that one spouse would have filed absent the BRA, the increase in losses to their unsecured creditors is quite small. Table F shows that for the entire sample of non-business filers (N=461) the joint filings represents 29% of the group and 33% of the total of unsecured debt. In the non-business bankruptcies, joint petitions account for only a slightly higher proportion of the outstanding unsecured debt than they do a proportion of the number of cases in the sample. Thus, counting joint petitions as two, although the total number of cases filed in Connecticut might be as much as one-third more since the Code, the loss to creditors, positing that one spouse of the two joint debtors would have filed a petition anyway, cannot be increased by anything near that amount.

The effect on particular groups of unsecured creditors may be substantially less than 10% greater than the typical individual case. We examined separately the kind of debt involved in each of the average cases for male, female and joint petitioners. Joint

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2. Administrator's Report, Tables F3B and F3D (1981).

3. We counted three individual petitions as joint because we discovered the case in our sample to be immediately preceded or followed by a substantially identical petition by the debtor's spouse. Among our subgroups, however, the proportion of joint cases varied widely. Our detailed sample of non-business petitions (Group A) was closer to the state data with 30% joint cases. The FDBA's were 39% joint, and in the non-business cases with significant assets (Group C), joint petitions occurred twice as often as in the entire sample.

petitioners have generally higher amounts of debt (and income) (Table G), but the sources of credit for joint debtors are more widely spread among the major types, and the losses per creditor of each type may not be much different for a joint case than for an individual case. We infer from our sample that joint petitions have a more pronounced effect on medical and merchandise creditors and finance companies (licensed lenders) than the individual cases; and less of an impact on banks, major credit card plans and credit unions (Table H). Different factors for the economic impact of joint petitions may be necessary for different kinds of credit extenders.

Counting bankruptcies after joint petitions became possible may also be approached as a function of whether the schedules showed one or two incomes. We were able to isolate that variable (the incidence of double incomes among couples filing joint petitions) in our detailed sample (Group A, N=107). When both spouses are employed, and given that the major debts are the liabilities of both,[4] there is a definite economic incentive for both persons to file since each has an income that is vulnerable to judgment creditors. In those cases we think that two petitions would have resulted even had there been no provision for joint filings. Therefore, the number of post-Code filings should be increased at most by the number of joint petitions having double incomes, but not necessarily by the full number of such joint petitions, since it is probable that some unemployed spouses joined in the petition for other reasons.[5]

The joint petitions had higher incomes by a substantial margin, about half again as much as males or females alone.

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4. See Lazorick, Obligations for Family Debts, 44 Conn. Bar Journal 236 (1970). The applicable statute has since been slightly revised to make it sexually neutral. Conn. Gen. Stats. § 46 B-36, 37 (1981).

5. Although an unemployed spouse may have no vulnerable property, other factors such as fear of continuing creditor harassment or a desire to "wipe the slate clean," may have made the slightly higher costs of filing another petition "worth it" despite the lack of financial justification.

Mean Incomes in Dollars (1979)[6]

Joint = $15,206

Males = $10,809

Females = $ 9,703

Yet these couples have incurred proportionately far less unsecured debt.

Mean of Unsecured Debt in Dollars
(At Filing Date in 1980)

Joint = $10,904

Males = $10,518

Females = $ 8,313

Among the debtors in Group A (N=107), we found 16 joint petitions with only one income (mean = $12,793) and 16 joint petitions with double incomes (mean joint income = $17,619). The joint petitions that make a difference to unsecured creditors are those with two incomes. Not only are both incomes apt to be subject to execution process, but those cases show substantially larger family incomes. These make up half of the joint filings in our detailed sample, Group A. Our tentative conclusion is that for proper comparison of the numbers of personal bankruptcy filings before and after the effective date of the Bankruptcy Reform Act, it may be necessary to increase the number of petitions after the BRA by only about half the number of the joint petitions to arrive at a numerical equivalent to the pre-BRA petitions that the same population would have produced under similar circumstances.

Our data also indicate that, as measured by the impact on unsecured creditors, the joint petitions do not have twice the effect of the two spouses' separate petitions, but probably discharge less than an additional 13% of unsecured debt.

6. Although the sample is small, the distribution of incomes between males and females appears to be similar to that of the overall distribution. Males had generally higher incomes. In just a few cases females were the major contributors to joint income.

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TABLE F

Joint cases as a percentage of

	Total Cases in Group	Total Unsecured Debt For Group
Group A n = 107	30%	32%
Group C n = 28	61%	62%
FDBA's n = 56	39%	35%
Total Sample non-business n = 461	29%	33%

TABLE G

n=[x]

	Mean 1979 Income	Mean Unsecured Debt	Mean Number of Creditors	Mean Assets*
Group A	$11,744 [101]	$8,732 [107]	13 [107]	$2,052 [101]
Group C	$15,714 [26]	$13,628 [28]	15 [28]	$2,633* [28]
Joint	$15,206 [32]	$10,904 [131]	19 [32]	$3,025 [34]
Males	$10,809 [36]	$10,518 [141]	10 [40]	$1,535 [39]
Females	$9,703 [29]	$8,313 [99]	11 [34]	$1,647 [32]
FDBA's	$15,656 [19]	$49,445 [56]	31 [31]	$4,579* [28]

*excluding real property

TABLE H

Percentage of Total Unsecured Debt of Each Type by Sex or Joint*

	All Debt (Unsecured)	Medical	Bank	Credit Cards	Merchants	Credit Unions	Finance Companies
Joint	37%	48%	31%	21%	43%	25%	49%
Male	39%	18%	42%	55%	27%	46%	35%
Female	24%	35%	28%	24%	30%	29%	16%

Totals greater than 100% in any column due to rounding.

*Less five male cases which were single debt petitions for relief from tort debt, and less five female petitions -- four single debt petitions (two torts, one student loan, and one AFDC) and one case in which debt was joint with ex-husband.

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E. Small Business Failures

We separated those debtors who were formerly in business (FDBA's) of which there were 67 (13%) in the 528 case total.[0] These 67 filings appeared to result from business failure or were closely related to the failure of a business in which the debtor(s) had been engaged. The FDBA's are larger cases and more of them would have resulted in payments to creditors under the stringent Connecticut State exemption law presently in force. In 30 of the 67 FDBA's (45%) there would have been something paid to unsecured creditors absent the federal exemption law, as compared to the 22 of 446 (6%) "non-business" cases. Table I. After deducting priority claims, the "loss" to unsecured creditors is about $4,466 per case with few very large or very small cases to skew these figures. The mean of the unsecured debt in these 30 cases was $38,024; thus there is a gross loss to unsecured creditors (not deducting the costs of liquidation and distribution in the bankruptcy) of about 12% of their average claim.

These business-related bankruptcy filings have much the same characteristics as those non-DBA's which would have resulted in some payment to unsecured creditors. Joint petitions predominate three-fourths (22 of the 30 FDBA's) are joint petitions; also the major or sole asset is most often residential real estate (in 24 of the 30 cases, or 80%).[1]

Of the 24 FDBA's with real estate equity, 18 (or 75%) were joint petitions, husband and wife holding title as tenants by the entireties. The mean amount of real estate equity in these 24 cases was $8,075 which again, of course, is an amount greater than the potential loss to all the unsecured creditors because priority claims[2] and the costs and fees of the liquidation would have to be deducted. The creditors are different in the FDBA's: banks, commercial lenders and trade suppliers, rather than the usual consumer creditors. Although a few small retail businesses were included (gift shops, shoe and clothing stores), many of the debtors in

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0. The non-business sample is 461 to which is added the 67 FDBA's for a total of 528. See Appendix A.

1. There was one "business" building of the 24 in which, however, the debtors resided on the second (upstairs) floor, before the whole was foreclosed.

2. Large priority claims were common in this class. Seventeen out of the thirty FDBA's in which distributions could have resulted had priority creditors listed in Schedule A-1. The mean of these claims was $3,586. Most were for taxes, composed of personal income, state withholding, and sales taxes.

these FDBA's were not engaged "in business" in the conventional sense. They were "self-employed" at about the same income levels as the non-DBA's and were engaged in much the same kinds of work, including such skilled trades as carpentry, plumbing, photography and printing.

The high cost to these FDBA's of getting credit and the squeeze resulting from their inability to extend credit to their customers has a greatly differential impact on these very small business enterprises. These individuals lack financial leverage. They are not able to borrow short-term money in the commercial credit market. And, perhaps most important to unsecured creditors, the FDBA's often pledged their personal property, and equity in their homes in order to obtain business credit. This group of debtors is likely, therefore, to be the most affected by further restrictions in the availability of bankruptcy relief (or of credit). Thus, an important potential effect of restrictions may be a chilling effect on the formation of small businesses and a potentially devastating impact on existing small business firms.

TABLE I

Frequency of Business-Related Petitions and Proportion of Sample Debt (Unsecured)

	N=	No. FDBA Petitions	FDBA as % of Sample	FDBA as % of Gross Sample Debt (Unsecured)
Sample 1	128	11	9%	32%
Group B	60	30	50%	74%
Total Samples 1 + 2	528	67	13%	45%

F. The "New" Debtors Under the Code

To assess the impact of the BRA's expansion of exemptions in Connecticut, we looked for those debtors who, under the state exemption law, could not have filed without turning over significant amounts of property to the trustee for liquidation.[0] These "new" debtors were made possible largely by the introduction of the federal homestead exemption into Connecticut. We found sixty cases out of our total sample of 528 (about 11%) in which the exemptions claimed in Schedule B-4 showed that the debtor retained more property than the present Connecticut state exemptions would have allowed.[1] Of those sixty cases, half were business-related (FDBA's). We set those cases apart so that the 30 cases remaining were cases corresponding to the type of cases making up Group A, the "typical" non-business consumer debtors. This group, 6% of our total sample, we designated as Group C.

The typical debtor in Group C is distinguished from his counterpart in Group A almost solely by his claim to a homestead exemption. While the "new" debtors appear to have higher incomes and carry higher burdens of debt than their counterparts in Group A (Table J), the proportion of joint petitions in Group C is significantly higher (Table K), which may account entirely for the apparent differences in income and debt burden.

When we examine assets other than equity in real estate, Group C's holdings are virtually indistinguishable from those of Group A. The three major types of property other than homes -- equity in automobiles, estimated aggregate value of household goods, and estimated tax refunds -- are held in roughly the same amounts by both groups. (Table L). These three major types of

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0. There are references to "needless" bankruptcy with the contention that as much as one-third of all non-mortgage, non-business debt that would be discharged in straight bankruptcy could be repaid because those debtors are filing bankruptcy petitions "as a matter of convenience, not need." A. F. Brimmer, Public Policy and the Economic Implications of Personal Bankruptcies (April, 1981).

1. We confirmed from the other schedules that the property claimed as exempt was actually in the estate, since it is a common practice to claim maximum exemptions as a safety measure, showing that the debtor has some leeway in the (unlikely) event that a subsequent appraisal shows the debtor's estimate of value to be low.

assets account for 77% of all assets in Group A, and 67% of all assets, other than homestead equity, for Group C.[2]

Among the types of creditors of Group C we again find virtually no difference other than a lower reliance on loans from finance companies, and, perhaps, slightly elevated burdens of credit card and medical debt. (Table M).

We are left with the conclusion that the debtor "taking advantage" of the expansion of exemptions in Connecticut (and presumably in the other states without any significant homestead exemption) is distinguished from the "average" debtor only by claiming a modest homestead exemption. The real estate claimed as exempt consists almost entirely of single family homes. The mean market value of all the homes was $43,289 (median = $40,000).[3] In comparison, the mean value of existing single family homes in the Northeast was about $60,300 as of November, 1979[4] and in the six-town area around Middletown, Connecticut, $60,661 for 1980.[5] Thus, the new debtors appear not to be from a different economic class at all, but merely to be those debtors of modest income (about three-fourths of the national median family income) who have converted a portion of that income into equity in modest homes.

The new debtors are apt to exist in the states without any homestead exemption and, to a lesser extent, one would suppose, in those states with homestead exemptions much smaller than the $7,500 per person allowed in BRA § 522(d)(1). The "spillover" allowed by § 522(d)(5) is apt to have a small impact because so few of the consumer debtors have any personal property of significant value.[6]

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2. Group C had three cases of the 30 without homestead exemption claims but with valuable assets of other kinds, namely a Navy reenlistment bonus ($1,400), an inheritance ($3,000) and shares of stock in a closely-held corporation ($5,000).

3. The cases with business involvements claimed generally higher market values for their homesteads (mean market value: $48,619) than did the debtors in Group C (mean market value: $37,970).

4. In June and July, 1979 the mean value in single family dwellings in Connecticut was about $58,000 (and the median between $67,100 and $68,000). National Association of Realtors, "Existing House Sales," Dec. 1979 at page 16; Conn. Housing Market, Annual Report, Dept. of Housing (1980) at page A-16.

5. Statewide values for existing homes are not available. These figures are the courtesy of Elizabeth Patee, President of the Connecticut Board of Realtors who compiled them from existing home sales in the Middletown MLS area. The authors know of no reason the Middletown figures would not be typical of housing prices in the rest of the study area.

6. Some states have, so to speak, watered-down versions of the spillover. New Mexico, for example, allows a $20,000 homestead exemption, but in lieu of that, a $2,000 exemption may be claimed by a debtor who does not claim any homestead exemption.

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TABLE J

	Mean 1979 Income	Mean Unsecured Debt	Mean Total Debt**	Mean Assets (All)	Mean Assets (Excluding Real)	Homestead Equity
Group A	$11,744	$ 8,732	$10,663	$2,052	$2,052	- 0 -
Group C	$15,714	$13,628	$16,144	$7,458	$2,633	Mean 8,324 (Median) 7,500)

*Mean assets are lower than scheduled homestead equity because the six cases in Group C not having interests in homesteads had significantly smaller holdings than those 22 which did have homesteads to exempt.

**Total non-mortgage debts. Secured debts are primarily car loans.

TABLE K

Joint Petitions as a Percentage of Total Group

	% of Cases	% of Income	% of Debt
Group A	30%	36%	32%
Group C	61%	74%	62%

TABLE L

Comparison of Mean Values of Assets:
Mean of Only Those Cases Reporting Owning That Type of Asset

	Equity in Auto	Household Goods	Tax Refund
Group A	$578 (n=86)	$1,048 (n=101)	$597 (n=30)
Group C	$595 (n=19)	$1,442 (n=13)	$625* (n=11)

*Less one case reporting an unusually high refund ($2,600).

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TABLE M

Debt of Each Major Category as Percentage of Total Unsecured Debt for Each Group

Type	Medical	Bank	Credit Card	Merchandise	Credit Union	Finance Companies
Group A	10%	16%	17%	15%	8%	15%
Group C	13%	17%	21%	13%	7%	10%

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APPENDIX A

DESCRIPTION OF THE SAMPLES

We took two separate systematic samples with random starts of voluntary Chapter 7 cases filed at Hartford during the calendar year 1980. The first sample was detailed, using an instrument designed to collect about sixty separate pieces of information from the petitions, statements of affairs and schedules of assets and debts in each case. Of this first sample of 128 cases,[1] too few cases (8) in which the federal exemptions could have made a difference in the decision to file were found. Since no reliable conclusions could be drawn about the type of case in which we were most interested, we went back to the files to take a larger, but less detailed sample.

In the second sample (N=400)[2] we recorded only four pieces of information:

(1) Whether the petitions was filed by a male, female, or jointly, by husband and wife;

(2) Whether the debtors were presently or formerly engaged in a business which appeared related to the bankruptcy;

(3) The gross amount of unsecured debt;

(4) Whether the exemptions claimed under federal law enabled the debtors to keep more assets than what would have been allowed under present Connecticut state exemption law.

Of the 400 cases in the second sample, we were able to identify 52 cases in which the federal exemptions may have left the debtors with more than they could have protected under state law. These 52 cases were then examined in the same detail as the cases in the first sample of 128 cases. We looked to see if, in each case, the unsecured creditors would have been paid more under the present Connecticut State exemption law. Conn. Gen. Stats. §§ 52-352 et seq. (1980).

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1. This sample is 5% or more of all the personal non-business bankruptcy filings in the District of Connecticut in 1980.
2. This sample is about 17% of all the personal non-business bankruptcy filings in the District of Connecticut in 1980.

From the first sample (N=128) we constructed a set of baseline data which described the "typical" debtor in some detail. We found, however, that the inclusion of cases in which the debtors were presently or formerly doing business (FDBA's) changed the results significantly. It appeared that the amounts and distributions of debt and assets for those individual and joint debtors presently or formerly doing business were so different from those of the other bankrupt debtors that it would be misleading to combine the two groups. The less detailed information from the second sample confirmed the existence of different distributions of gross unsecured debt for the two groups. The division between ordinary debtors and those presently or formerly engaged in business, furthermore, was a major feature of the selected class of debtors who took advantage of the federal exemptions. Small, usually very small, FDBA's used the expanded federal exemptions far more frequently than did the non-business debtors.

For better comparison, therefore, we separated the business-related cases from those petitions that showed no evidence of either of the debtors having been engaged in business. This sorting process, however, could not always be done on the basis of any one piece of information. Those debtors presently doing business and filing the appropriate Statements of Affairs were only part of the business-related group. Others were found through the answer to question 2C of the Statements of Affairs for Debtors Not Engaged in Business. Some, however, were also discovered in the first sample through a heavy concentration of commercial and trade creditors in the schedules of debts. Since in the larger, less detailed sample (N=400) we examined only the petition and question two of the Statement of Affairs for indications of business involvements, the number of business-related personal Chapter 7 cases is less certain. We did identify a few of those in which the schedule of creditors having unsecured claims held the only evidence of a business connection when alerted by the size of the unsecured indebtedness, but we could have missed some whose debt was closer to the mid-range of cases without business involvements.

The resulting groups of cases we have used to compare the effect of federal exemptions in Connecticut are defined as follows:

GROUP A is taken from the first (detailed) sample of 128, less 8 cases in which the availability of federal exemptions could be said to have made a difference in the decision to file; and less 11 more cases which were business-related, and two cases lacking sufficient information. The remaining 107 cases represent the group of debtors without business involvements who could have filed the same petitions using the present Connecticut state exemptions without having to turn over property to the trustee. The federal exemptions in these cases did not work to the disadvantage of unsecured creditors, since no more of the debtor's property was protected from them than was protected before the Act.

GROUP B comprises the eight cases from the first sample and 52 similar cases from the second sample in which it appeared that the use of federal exemptions enabled the debtors to retain more property than would have been possible under state statute. We eliminated two cases from the group, however, because, from other evidence in the files, it could be shown that no benefit was lost to unsecured creditors: in one, the claimed exemption in real property was lost as the result of a strict foreclosure, and in the other, the margin of equity went to satisfy nondischargeable priority claims. This group, therefore, includes cases of both business-related and non-business debtors in which there might have been distributions to unsecured creditors if the use of present Connecticut state exemptions had been required.

GROUP C (N=28) is a subset selected from the 60 cases in Group B, and comprises only those cases from Group B not having business involvements. Group C is made up of the same kinds of debtors as is Group A, except that the use of federal exemptions by the 28 debtors may have resulted in some losses to unsecured creditors that would not have been possible if the debtors had been limited to the Connecticut state exemptions in effect during 1980.

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APPENDIX B

OUR METHODS

In the detailed samples, we examined the Statements of Affairs for occupation and length of present employment, income for the two previous calendar years, previous bankruptcies, number and types of lawsuits, wage or property executions and repossessions, and catastrophic losses from fire or theft.

Our instrument was designed to break down priority creditors (Schedule A-1) in order of the priorities set in § 507. However, we found only taxing authorities as creditors having priority claims. The priority claims had no impact except in those cases which might have resulted in distributions to unsecured creditors had the debtors been restricted to present state exemptions. In those cases we "gave" the priority creditors the benefit of their priority and in our calculations reduced the assets available for distribution to other creditors accordingly. In most cases, however, the priority claims consisted of automobile taxes (township personal property) of little consequence to the debtor's financial problems as a whole.

Creditors having secured claims (Schedule A-2) were almost exclusively secured either by residences or motor vehicles. Security interests in household furnishings appeared in a negligible number of cases, and those seemed to be purchase money security interests in particular household appliances. We made note of judgment and statutory liens on real property as secured claims.

Our treatment of unsecured claims (Schedule A-3) was designed to determine which classes of creditors are losing the most money. We divided unsecured debts into six general categories: medical expenses, closed-ended bank-originated loans, open-ended credit plans (major credit cards), credit union loans, loans from finance companies, and general merchandise purchases. In addition, we looked for a few special kinds of debt, either because they are the matter of some political controversy or because they might give a clearer indication of the causes of bankruptcy, namely student loans, child support assigned to the state, public benefit overpayments, legal fees, and debts to co-signers, for fuel oil, and for back rent.

Within each category of debt, we calculated the number of creditors and the gross amount of debt of each type. In the medically related debts, we included hospital or institutional charges, debts owed directly to physicians, dentists, and associations of medical professicnals such as diagnostic radiology groups, and ambulance and pharmacy charges. The category of bank loans included closed-ended credit extended by commercial banks, savings and loan associations and mutual banking institutions, but we did not distinguish among the lenders. The distinction we did draw instead was between the types of credit, by placing open-ended credit plans, whether offered by banks or by national plans such as American Express, in a separate category. The open-ended credit plans were typically major credit card plans such as Mastercard or Visa, but we included plans such as those allowing credit in the form of checking oyerdraft priyileges in this category as well. The category for finance companies includes the kinds of lenders authorized ("licensed lenders") to make closed-ended small loans under Conn. Gen. Stat. §§ 36-225 et seq., but included a few out-of-state high interest rate lenders who do business only by mail in Connecticut. Debts for merchandise include those to retail merchants, and those retail stores which issue their own credit cards for use in their own outlets; this category therefore includes merchants from sole proprietors up to the largest credit-extending businesses in the country.

Some types of debt fall outside of any of our categories, or were not described specifically enough in the schedules to allow for categorization; primarily these were debts owed to natural persons for loans or tort claims. Debts other than taxes owed to the State of Connecticut were generally identifiable either as medically related for treatment in state institutions or as assigned child support. Debts owed to individual natural persons which could not be categorized were generally insignificant fractions of the total debt in any case except in a few cases involving failed businesses. We expected to find natural persons listed as co-signers, especially among credit union, finance company and bank loans. However, we found only two cases in which co-signers were listed and identified as such.

We attempted to be as specific about the kinds of assets (Schedule B) involved in the cases as we were about the types of debt. For several reasons we were not able to do so, however. Probably because the normal case has assets well within the exemption limits, the practice of listing assets in Schedules B-1 through 3 and claiming them all as exempt in Schedule B-4 is perfunctory. Also, there was evidence of confusion regarding the federal exemptions, possibly because the claim to exemptions is the only significant change on the face of the standard forms. A large number of claims to exemptions were amended at or following the first meeting of creditors. The most common amendment was to include a potential federal income tax refund of "unknown" value. A second common amendment was to claim as exempt the amounts of wage executions which could have been recovered by the trustee under § 547, so that the debtor could recover these amounts instead under § 522(h). These two amendments were made at the suggestion of the trustee and represent common potential assets that we were unable confidently to verify. For most other property, we have less doubt about the value claimed as exempt. For those larger pieces of property securing loans and mortgages, we were able to compare the equity claimed as exempt with the equity shown in other schedules. In many instances, the debtor claimed the maximum exemption, but had less equity in the property claimed as exempt. (This approach is easiest for lawyers and involves less risk.) We used the debtor's actual equity rather than his claimed exempt amount to calculate the assets per case. A few cases treated the federal exemption as a blanket exemption of $7,500 per debtor, despite the type of property involved.

PART II

Comments on the Proposals of the Consumer Creditors

On the basis of our data, we think that the industry proposals to reverse the reforms of the Bankruptcy Reform Act are both unwise and unwarranted. Our data show that the undoing of the reforms in the Act would tend to

1) affect (penalize) a class of persons who cannot afford additional economic burdens;
2) increase administrative costs in the bankruptcy courts, which, unless shifted to the debtors who can least afford them, will negate the anticipated benefit to the industry;
3) effect a transfer of both administrative and actual costs, which would result in an income transfer from those persons at the levels of our economy piecemeal to consumer credit extenders who are still conducting business at a profit.

The most objectionable aspect of the proposed industry legislation is that it all tends to shift the burdens, and thus the costs, of demonstrating the need for relief under the Code to the debtor. In its worst aspect, the industry proposals would transform the Bankruptcy Courts into agencies for enforcing federal garnishment procedures, which would be necessary for the success of the proposed law, but which do not yet exist in federal law. We view the industry's proposals as attempts to mitigate the effects of the economic difficulties of the past few years by shifting the economic injury to another sector of the economy, in this instance to those families which can least afford it.

To some extent our data may be used to guess at the impact of the proposed industry bill which has been widely circulated and is familiar to the members of this Committee. In particular we question the provisions Section 7, page 18 which would amend BRA Section 523 and which provides that contractual consumer debts cannot be discharged (i.e., there will be, in effect, a compulsory Chapter 13 with the new provisions of Sections 1322 and 1325 of the industry proposal, page 37) "unless such debts or a portion thereof

cannot reasonably be paid by the debtor from the debtor's anticipated future income."

This proposal would substantially increase both the administrative and the external costs of bankruptcy by requiring the inclusion of detailed, yet necessarily speculative, information in the bankruptcy filing which must be scrutinized by the highest paid members of the system, the bankruptcy judges. Our data show that the typical debtor is employed in seasonal or marginal trades, mostly hourly paid, factors which render future income highly unpredictable. When such a person has been forced into bankruptcy by unexpected losses of income or additions to debt, to require that he or she commit a dollar amount of unpredictable future income without regard to unpredicted (e.g., medica' expenses for the payment of past dischargeable debt is a form of involuntary servitude.[0]

Of course, the creditor business firms will object to Chapter 7's. They are apt to do so routinely with standardized printed forms on which a clerk will insert the particular information of that case. Of course this will deter litigation. The creditors do these things en masse (as they formerly did with exceptions to discharge and with efforts at reaffirmation) at a low cost per case (which is tax deductible). The individual debtor will incur legal fees and costs at a higher rate because lacking the cost economies of scale, and most debtors will have to lose more income by missing days from work. Moreover, the individual debtor's fees and costs will not be tax deductible as an ordinary business expense. The considerable leverage which the credit business firms have and exercise will force most debtors to settle, whatever the merits of the case. It was that way before 1970 with the "fraud exception" under the old Section 17(2) (now codified as changed in BRA Section 523(c)(2)(B)). There is also the extreme ambiguity of the terms: "some portion," "reasonably be expected to pay" and the like. These provisions only engender more litigation and under the most unequal circumstances.

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0. Uninsured medical expenses, for example, cannot be anticipated unless one is prepared to speculate that, at filing, it is apt to reach eight to ten percent of the total family debt with apparently distinct variations for males and females. This suggests that anticipated income and expenses for two or three years (not to say five years) in the future is only apt to generate more court appearances.

The imposition of some conventional guidelines may, by specification, show how harsh this compulsory Chapter 13 would be and how few debtor families could repay without suffering.

To demonstrate the impact of shifts in the burden of cost for bankruptcies (which, it must be emphasized, the industry proposals would increase as well), we must emphasize the plight of the typical debtor. For this comparison, we have used as a standard the BLS lower living budget for New York and Northern New Jersey (lower than Boston, the other metropolitan area in the Northeast Region) for Autumn, 1979. That lower budget was $12,949. The BLS National lower living budget for urban families of four was $12,585 during 1979. Another guideline is that the poverty threshold for a non-farm family was $7,412 during 1979. Consumer Income, Series P-60, No. 127, Bureau of the Census (1981).

Our sample of bankrupts is near-poor. They are above the poverty threshold, but most of them earned less than the BLS lower living budget. The mean and median incomes of our detailed sample (N=123) that recorded incomes for 1979 are below the applicable BLS lower living budgets: Mean = $11,800; Median = $11,000. (If we removed a few aberrants -- the only three large incomes of the group ($32,000; $29,788; $28,794) -- the mean income would be lower and more representative of the whole sample.)

The mean total debt of the sample (N=128) is $15,110; the mean total of unsecured debt is $11,069. To liquidate only unsecured debt (and not adding interest and administrative costs), could consume almost one-third of the typical debtor's income. To liquidate all debt over three years would take from the typical debtor family more than 42% of its mean total income, an impossible burden. And one which is not made easier by letting bankruptcy judges decide what is a reasonable portion of debts which can be paid out of an unknown and relatively unstable future income.

For the six-tenths (68 of 123) whose income was below the BLS lower living budget, who are subsisting at an average of $100 a month below the lower living budget, the preclusion of straight bankruptcy and the compulsory Chapter 13 seems harsh and unconscionable. Moreover, 90 of 123 (73%) had incomes less than $200 per month above the lower living budget. That these debtor families could be forced to pay

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anything, even over five years, (and interest and the Chapter 13 trustee's fee -- estimated at 10% -- must be added) is incredible.

Only 55 of the 123 cases (45%) have incomes above the lower living budget; and only 10 of the 123 debtors (8%) reach the BLS intermediate living budget of $20,517.

Perhaps the 10 in our sample of 123 (8%) whose incomes reach the intermediate living level budget could manage some payment. However, the larger the incomes (mostly joint petitions with two incomes and the business-related bankruptcies) the larger the debt. The mean total debt of these ten bankrupts was $18,778 while their mean income was $25,663 (median = $25,000-$25,335).

The industry proposed § 1325(a)(3) and (page 37, industry proposal) is meaningless without specification: that the Chapter 13 plan shall "represent a bona fide effort which is consistent with the debtor's ability to repay his debts, after providing support for himself and his dependents," necessarily requires individual judicial determinations, difficult judgments of how much of a debtor's disposable income can be taken by the order of a federal court.

The unenviable position of the consumer debtor wage earner under industry proposed § 1325(a)(6) (page 37) is

(i) pay 70% of all allowed unsecured claims (although the examples given are all secured claims);[1] or

(ii) be a financial ward of the bankruptcy court for up to five years.

The tone and the wording of the comments to the industry proposal would make one think that, for example, recent extensions in the duration of secured consumer credit were the result of consumer demand. Secured loans on a new car were extended to four

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1. The secured creditors listed in the industry proposal (bot, page 38-top, page 39) will not incur losses unless they have made their secured loans imprudently. Indeed, we have good evidence that upon default, surpluses -- excess and unlawful profits -- are made on resale of repossessed cars in some 15% or more of the cases and artificial deficits are created in a larger fraction of the repossessions of cars by means of sales which never took place or are arranged between the financer and the seller-dealer. See the findings of the Administrative Judge in Ford Motor Co., No. 9073 (F.T.C., Jan. 4, 1979), rev'd on other grounds, Ford Motor Co. v. F.T.C., ____ F.2d ____ (9th Cir. 1981).

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years by GMAC and others in order to sell more cars and sell more money to buy those cars and thereby make more money. There is nothing wrong with that. It is simply good marketing practice. But please not to use that unrelated standard to dump on consumer debtors faced with bankruptcy.

These proposals will convert the bankruptcy courts into official collection agencies for the consumer credit industry. If the creditors want that, they should pay for the costs of such collection and not ask the Congress to take it out of the hides of the debtors. Let the business firm creditors pay the actual court costs and the charges for the Chapter 13 trustee.

Proposed new § 523(d) (page 15, industry proposal) is incredible. That a $200 debt is termed the unconscionable and fraudulent practice of "loading up" (page 16) is simply abusing the English language. Perhaps the industry spokesmen meant only to take poetic license. That is not what I - and not what most persons - mean by "loading up." And whether a $200 loan or credit purchase [1A] is fraudulent depends upon the debtor's intent which is a matter of fact to be determined by a judge or jury. It is repugnant to make any such transaction fraudulent as a presumption of law. And again, such a provision will give the creditor business firms more (too much) leverage so that they can compel the debtors to pay because the expense of litigating will be far greater than $200.

Proposed § 523 (a)(2)(A) is simply worse and more misleading than the present § 523 (a)(2)(A) or the predecessor § 17 a(2). The "fraud", if any, is more often that of the lender businesses whose standard forms and routine practices are designed to encourage, even, create, false and misleading financial statements. And the lenders' personnel do not rely on those statements. If they were that dumb, they would have been fired by their overseers. These lenders get credit reports and anyway rely much more on past experience with their customers. The subject has been studied[2] although

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1A. The average debtor owes some 40 times that $200 when forced into bankruptcy.

2. See Shuchman, The Fraud Exception in Consumer Bankruptcy, 23 Stanford Law Review 735 (1971) and Shuchman, Impact Analysis of the 1970 Bankruptcy Discharge Amendments, 51 N.C. Law Review 233 (1972)

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the industry commentators would have you believe that they are still the victims of, rather than the creators of, this "fraud." These are not naive lenders. They are in the business of selling money at a profit and the business remains profitable with consumer credit still increasing.

The addition of "false credit history" or falsification of other facts reasonable related to the debtor's incurring liability for the debt should be subject to the same four conditions of § 523(a)(2)(B) which were codified as the result of repeated and consistent experiences of state courts and bankruptcy judges over many years.

We estimated that the "fraud exception" proceedings had been about halved in number by the statutory changes and case interpretations of § 17 a (2)[3] embodied in BRA § 523(a)(2)(B). The four requirements in the bankruptcy courts avoided litigation: The statement must be in writing. It must be materially false about the debtor's financial condition, the creditor must have relied on it, and the debtor must have intended to deceive. The proposed change is the consumer credit industry's effort to get in by the back door what they have been unable to do directly because they cannot prove their reliance or the debtor's intent to deceive.

If these creditor businesses want to include such matters as "length of time at residence, or length of time on job" (page 16 of industry proposal) and if they do in fact rely on such information, let it be included in § 523(a)(2)(B) so that we will not have the old games of creating an historical record for no reason other than to gain the considerable leverage (because of the costs) which results in forcing debtors in bankruptcy to compromise and pay half the creditors' claims[4] which would otherwise be discharged.

The term "good faith" [the industry proposed new wording of § 523(d)-page 15, which is to become § 523(e)] will again generate more litigation because more subjective and more difficult to apply than the present test of § 523(a): "unless the granting of

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3. Shuchman, Impact Analysis of the 1970 Bankruptcy Discharge Amendments, 51 N.C.L. Rev. 233(1972).

4. Ibid.

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judgment would be clearly inequitable." The intent of the Commission on the Bankruptcy Laws and of the Congress was quite clear. Don't start these mostly spurious actions with such unequal bargaining power unless your case is clear and convincing; otherwise you will be liable for costs and a reasonable attorney's fee.

A compromise may be possible. The BRA could require that every request for determination of dischargeability be accompanied by the numerical answers to two simple questions: (1) In how many bankruptcies of your borrowers who filed petitions did your company file or threaten to file such a request? (2) The same question for the lender's last fiscal or calendar year. That might better inform us about the "good faith" of the lenders, and their shareholders would find out how often their office managers were bilked in the same few ways by tens of thousands of simple and uneducated but felonious borrowers.

Section 5 of the proposed industry bill (page 13), the new § 722(b) will yet again require more court time and expose the debtors to additional costs, legal fees and loss of income due to court appearances. The non-purchase money lenders do not rely on these items as collateral. The major use of the security interest in household goods and the like was the fear, the sometimes effective terror created by the occasional repossession and resale, often in public on the street in front of the debtor family's dwelling place. Another use was the threat of criminal proceedings when the item(s) could not be found. Such collateral little or no value and has no cumulative impact to speak of because consumer creditors do not rely on that collateral and very satisfactorily do business in states in which no non-purchase money security interest can be taken in household goods and similar collateral.

Future income as an asset is an appealing but ephemeral notion and perhaps even quite illusory. It appears on no balance sheet. One cannot depreciate this "asset" with age (except for owners of professional athletic teams). The language might lead to the inference that (non-consumer)business credit and loans are made on the basis of assets as collateral and that such loans are different in kind. In that regard, business credit should be divided into at least two kinds: the typical and numerous very small business

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bankruptcies (some of which appear as personal bankruptcies, what we have called FDBA's) and other business bankruptcies.

The small business bankruptcies often involve companion personal bankruptcies or companion Chapter 11's. Although I have no independent data to support this view, there are corroborative comments by practitioners (see, e.g., Leibowtiz, Officers' Personal Liability for Corporate Debts When Bankruptcy Ensues, 82 Commercial Law Journal 10, 12 (1977)) and "is supported by a finding that nearly four-fifths of loans to small business were secured, compared to less than one-fifth of the loans to large business which were secured."[5] And much of the collateral pledged as security for the loans to small business is the personal property and the homes of the owners and their spouses.

One need only examine a sample of the larger bankruptcies and Chapter 11's to see that the creditors did not rely only or mostly on the tangible assets fo the debtor business but relied more on the continued business of the borrower and its ability to repay out of future income. In the Lockheed ("bail out") loan guarantee hearings, a consortium of the largest banks in the Nation testified that, upon liquidation, they would recover about one-fifth of their loan balances. I think that would also have been true of Chrysler if not for the federal loan guarantees. Chapter 7's and Chapter 11's of large business firms upon actual or threatened liquidation yield and are seen to yeld very little even to secured creditors and little or nothing for unsecured non-priority creditors. These are not different in kind from personal bankrupcies in regard to the anticipations of creditors and the expected source of the repayment.

The industry spokesmen's comments regarding secured consumer credit are misleading in yet another more direct manner. They claim that the "basic assumption of the consumer credit industry is that consumers will pay debts out of future income rather than from liquidation of present assets." (Industry proposal comments, page

5. Shuchman, Theory & Reality in Bankruptcy, 41 Law & Contemporary Problems 66, 95 (Autumn, 1977) citing Security Pledged on Business Loans of Member Banks, 45 Federal Reserve Bulletin 1114, 1116-18, 1127 (1959).

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19) The Federal Reserve Board Monthly Bulletin indicates that some $138 billion (43% of all consumer credit) was secured by cars and mobile homes as collateral. Table A-40, FRB Monthly Bulletin (August, 1981). This is by far the largest category of consumer credit. The consumer credit industry knows the frequency of default to a decimal point. The depreciation schedules are well known and there is no need to rely on the debtor's income. The down payment and the schedule of payments can be and are adjusted for such collateral which is by far the largest single category of consumer credit. The practices documented in Ford Motor Co., No. 9073 (F.T.C., Jan. 4, 1979) suggest that these secured creditors do look to their collateral and in a set of cases are able to adjust to defaults and not be hurt.

All the property in the industry proposed § 722(b) (page 13) is exempt (not only under federal law but under most state laws) from non-purchase money non-possessory security interests and cannot be the subject of execution process by the levy of a judgment creditor. Now we are told that the bankruptcy court may require (my italics) the creditor to accept payments in redemption. One might suppose from the language that these creditors have been compelled to do something unprofitable or even more distasteful. In rality, they are seeking an advantage (some more vigorish) they do not now have and should not have because they do not need it.

How would you like your dialysis machine or oxygen supply to be non-exempt and subject to redemption by installment payments? And for any old debt, not necessarily a purchase money debt evidenced by a security interest.

There is no need to delete BRA § 522(f)(2). If the debtor needs to or wants to redeem such exempt property and the creditors are agreeable that that be done by installment payments, (as the industry's § 722 proposed (pages 13-15), that is all to the good. But under no circumstances should this Committee agree that BRA § 522(f)(2) be deleted!

The commentary of the authors, like most of the industry proposal document, is the rhetoric of pernicious propaganda, an advocate's brief in the guise of dispassionate scientific analysis.

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PART III

Addendum on Proposed Senate Bill

A. From the date on which the Bankruptcy Act was signed by the President on November 6, 1978, all lenders were aware that unsecured credit extended in the next 11 months would be subject to the federal bankruptcy exemptions to take effect on October 1, 1979. They could have prudently adjusted their practices (and some probably did) during those 11 months.

The secured creditors were also aware of BRA § 506(a) that their secured claims in bankruptcy would be limited to the value of the collateral, the excess being an unsecured claim. And one could go on through virtually all those provisions of the Bankruptcy Reform Act that, it is now claimed, will result in the bankruptcy of the consumer credit industry.

B. The suggested compromise to the industry proposal of adding a subsection (f) to § 109 is little better.

> (f) An individual may be a debtor only if such individual cannot pay a reasonable portion of his debts out of anticipated future income.

This has only the slight improvement that it diminishes the self-serving aspect of the industry proposal by treating other creditors as well as the consumer credit business firms. The phrase "a reasonable portion of his debts" is nearly as ambiguous as the industry proposal and the problems of "anticipated future income" remain intractable. Both these provisions will also generate more litigation taking up scarce judge time and resulting in considerable expense which should not be borne by the public fisc.

I do not think the bankruptcy judges want to undertake the very serious and time-consuming burden of individual analyses of debtors' situations and especially when that involves predictions over the next two years; nor are they -- or any other group -- especially competent to do so. Estimates of income and expenses in the two years after the petition will be hazardous guesses. The burden of proving changes will rest on the debtor family. The costs, fees and time lost from work will all be borne by them, those least able to afford additional expenses.

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Sections 109(f) and 305(d) of the proposed Senate Bill will generate tens of thousands of law suits as will the necessary provision for changes in any order for payment based on the debtor's changed circumstances.

C. The statement "Effects of the Proposed Language" impresses me as a set of biased guesses and omits more of substance than it contains. Prediction 2 regarding "debtors who can pay some debts out of future income" neglects to tell us of the lawsuits which will arise when any employed debtors seek relief under Chapter 7. Since more bankrupt debtors are employed than not* -- indeed a major precipitating cause of filing is wage garnishment or the threat of such proceedings -- it would be more reasonable to assume that hundreds of thousands of objections will be filed; and that may be multiplied because creditor business firms can object and seek changes during the pendancy of a Chapter 13 plan as well as to the filing of the Chapter 7 petition.

I very much doubt Prediction 4(c) that "limited ability to pay will make creditor objection unlikely because of low potential return." The costs of objecting are small because done routinely on standardized forms in fair numbers, and the costs are tax deductible so the consumer credit firms have little to lose by filing objections and seeking changes wherever possible (probably most employed debtors) and even remotely apt to succeed.

Prediction 6 is in the form of a statement which is so limited and so artfully stated as to be quite misleading if not simply untrue. The bankruptcy "court only determines whether debtor has ability to pay debts out of future income." (My italics) In this context that is rather like saying that a jury only decides whether an accused is or is not guilty of a crime or is responsible for a civil wrong.

The complex of factors that go into the determination even of present ability to pay -- to say nothing of the fiction of a two-year prediction of income and expenses -- is not and cannot be a routine activity. It will take careful, individual judgment re-

*Of the 107 reporting on employment in our detailed sample, only six (5.6%) were unemployed at the filing date.

sulting in an adjudication, an order of a federal court, by the bankruptcy judge, the most expensive participant in the bankruptcy proceedings.

What this proposal entails is that the bankruptcy courts will function as free official collection agencies, presumably ready to enforce their orders by wage garnishment (a new and perhaps unlawful activity) or by contempt proceedings, civil and perhaps criminal in some cases. I take it that imprisonment (fines are not apt to work with debtors) will be the ultimate threatened sanction.

The American people deserve that these proposals be dismissed out of hand and with alacrity.

Prepared Statement of Ellen Broadman

Mr. Chairman and members of the subcommittee, Consumers Union* appreciates this opportunity to testify on the proposal to restrict the eligibility criteria for Chapter 7. Under this proposal, individuals could go through bankruptcy under Chapter 7 only if they "cannot pay a reasonable portion of [their] debts out of anticipated future income." Consumers Union strongly opposes this proposal.

I. This Proposal Would Undermine The Bankruptcy Law

The overriding purpose of bankruptcy law is to allow individuals who have become overburdened with debt to escape inordinate debt burdens and start life afresh. Our society as a whole benefits from this law. Consumers who otherwise might

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*Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide information, education, and counsel about consumer goods and services and the management of the family income. Consumers Union's income is derived solely from the sale of Consumer Reports, its other publications, and films. Expenses of occasional public service efforts may be met, in part, by nonrestrictive, noncommercial grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with over 2.8 million circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

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commit crimes to obtain money to meet overwhelming credit payments have an alternative. Individuals whose family life, personal health or emotional well being has suffered due to serious financial woes can obtain needed relief. With a fresh start, free of debt, they can lead wholesome, productive lives.

The proposal before this Subcommittee would preclude virtually all debtors, no matter how overwhelming their personal debts may be, from using Chapter 7 to secure a fresh start. Arguably, only the disabled, terminally ill or elderly would be eligible for bankruptcy under this proposal. All other debtors probably could pay off a "reasonable" portion of their debt with their entire anticipated future earnings, especially if living expenses are not first deducted from their income.

The proposal leaves the determination of what is a "reasonable portion" of the debt to the whims of individual bankruptcy judges. Is 15%, 25%, 50% or some other arbitrary figure reasonable? With the advent of variable rate mortgages and consumer loans, bankruptcy courts will not be able to determine the precise amount an individual will owe. That amount will depend on the interest rates which are applied in the future. Thus, courts will not be able to determine what percent of these variable debts a borrower will be able to pay.

The proposal also would require courts to consider a borrower's entire projected lifetime earnings. Courts could not even deduct reasonable living expenses from those projected earnings to determine if borrowers would be able to pay their debts. An individual whose lifetime earnings could cover some of their debts--assuming no expenditures for personal necessities--could not secure bankruptcy relief.

This provision is wholly at odds with the law's basic precept that debtors should be allowed to maintain a minimum, decent standard of living. This policy is reflected in the law's provision that allows debtors who go through bankruptcy to retain minimal belongings needed to lead a normal, sucessful life. For example, debtors can keep some of the tools required

to pursue their trade. They can retain an inexpensive motor vehicle so that they can travel to work. In keeping with this policy, individuals should not be forced by Chapter 7 to live under impoverished conditions while their entire (anticipated future) income is used to pay their debts.

This proposal also conflicts with the law's objective of allowing individuals to avoid a lifetime of overwhelming, unending debt payments. Chapter 7 is not intended to force borrowers to struggle throughout their lifetime to meet credit payments just because they might conceivably pay a reasonable part of their debts before they die. Yet, if all anticipated income is considered in deciding whether an individual can utilize bankruptcy, borrowers who are not eligible for Chapter 13 may be forced into a lifetime struggle to meet their debts.

The vague standards contained in this proposal are likely to be applied quite differently by various bankruptcy courts. Inequities may well result. Courts are likely to differ in what they consider to be a "reasonable" amount of debt for debtors to repay; this has been a vexing problem with Chapter 13. Some may anticipate that debtors will receive larger amounts of future income than will others. If the proposal were amended to allow bankruptcy courts to deduct reasonable living expenses from income before determining whether individuals could afford to pay their debts, additional disparties would undoubtably exist. Individual judges are likely to disagree on what constitutes an appropriate living standard. Altogether, this proposal would introduce new uncertainties, inequities and hardships under Chapter 7.

II. Bankruptcy Should Be Available In Our Risky Credit Markets

Consumer credit has become increasingly risky for consumers. Mortgages with variable interest rates--and uncertain monthly payments as a consequence--are replacing the familiar fixed-interest mortgage. The interest rates on variable-rate mortgages typically are tied to an index. When the index rises so does the mortgage interest rate and monthly payment. Changes can be quite substantial. Consumers who in January 1978 purchased a $50,000 mortgage with an interest rate

tied to a 6-month Treasury bill index would have watched their mortgage interest rate jump from 9.15% to 17.39% by January 1981. Their monthly payments would have skyrocketed from $408 to $722, a 77% increase. A recent national survey of savings and loan associations discovered that 48% offer these mortgages with no limit on interest rate fluctuations.[1/]

With some variable-rate loans, the principal owed can increase. This is called negative amortization. It occurs when the monthly payment increases are limited. If the interest rate rises rapidly and the monthly payment does not cover all the interest owed, unpaid interest is added to the debt--so the consumer pays interest on interest. The increase in a mortgage debt can be substantial if interest increases are large and the limits on payment changes are low. Under some mortgages, the intitial monthly payment is set too low to amortize the loan. The debt therefore increases from the first day of the loan term and continues to increase unless the interest rate drops.

This variable-rate phenomenon is spreading to non-mortgage credit as well. In the future, an individual with variable-rate mortgage and auto, home-improvement, education and credit-card loans may desperately need the relief provided by the bankruptcy law when interest rates rise significantly. The introduction of variable rate loans makes it virtually impossible to apply the proposal before this subcommittee.

Not only is credit becoming riskier, but creditors are now attempting to erase all state consumer-protection laws that govern consumer credit charges. A federal bill introduced in the Senate (as S. 1405 and as Title IV of S. 1720) and in the House (as H.R. 2501) would preempt these laws. These bills would legalize usury, and permit extortion and various other unsavory creditor practices. They would abolish rate ceilings used against loan sharks charging 50 or 60%. They would erase state laws that prohibit lenders from assessing unfair fees they once hid in the fine print of credit contracts. They also

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1/ American Mortgage Insurance Company, Survey of Savings & Loan Associations' Adjustable Mortgages (September 10, 1981).

would eliminate substantive consumer protections tied to interest-rate ceilings.

In states that have lifted usury ceilings, abuses are coming to light. Unknowing consumers in Arizona, for example, have been enticed to sign second mortgage agreements with interest rates of over 50%. In other states, usury laws have been used to invalidate such unfair charges. In the District of Columbia, for example, second mortgage scams have been ruptured using D.C.'s consumer usury law. A local consumer reporter, Ellen Kingsley, recently presented a five-part series on Channel 9's evening news describing these schemes.

In each case, an agent for a mortgage company prayed on an unsophisticated homeowner by offering a substantial loan with small monthly payments. In one case, an elderly women was offered a $13,500 Deed of Trust with a $135 monthly payment. She willingly accepted. She did not realize that $5,000 of that loan would be paid to the mortgage company for various fees so that she would only receive $8,500 in cash. Moreover, she was not told that at the end of one year, she would owe a balloon payment of $13,500. The monthly payments only covered interest. After adding all the fees and interest she paid, her effective interest rate was 80%.

After the news series ran, Ms. Kingsley reported that twenty-one viewers called her to report similar contracts they had been hoodwinked into signing. Some of these homeowners were able to prevent foreclosure proceedings and avoid losing their homes because of the D.C. usury statutes. If these creditor-backed bills become law, consumers may be without any protection against these vicious practices.

If creditors want to deregulate consumer credit markets, erase state consumer protections, and extend extremely risky loans, there is greater, not lesser need for the only meaningful excape consumers have from escalating, uncontrollable debt burdens.

III. <u>The Proposal Could Increase Improvident Granting Of Credit</u>

If lenders can rely on an individual's long-term earnings for debt repayment, they are more likely to promote credit

aggressively to people who cannot meet the payments. Overextension of credit could become a serious problem. Already, debtors most frequently cite "too much credit" as the major reason for seeking bankruptcy relief.[2/] Bankruptcy law should not be weakened to encourage irresponsible lending policies that burden individuals with endless debt. The current law better assures that creditors share responsibility for improvident lending of credit.

IV. The Increase In Bankruptcies Does Not Alone Justify Amending This Law So Soon After Its Enactment

Various creditor groups blame the recent dramatic rise in bankruptcies on the October 1979 changes in the bankruptcy law. They argue that the bankruptcy increases justifies restricting its availability. However, there are many factors other than the 1979 revisions in the law that have affected bankruptcy rates. Since October, 1979, interest rates have vacillated wildly and remained at unprecedented peaks, unemployment has reached extraordinary nighs, the ratio of consumer debt to income has been substantial, and the economy has been quite depressed. The correlation between bankruptcy rates and both unemployment and interest rates has been well documented.[4/] The level that states have set their usury ceilings (which control how high interest rates can go) have also been shown to be related to bankruptcy levels.[5/]

Marital difficulties, medical expenses and age also have been shown to be correlated with bankruptcy rates.[6/] In recent years, divorce rates and medical rates have risen

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2/ Brimmer, A., Public Policy and the Economic Implications of Personal Bankruptcies, Statement before the Senate Subcommittee on Courts (April 3, 1981) at 16 (57.5 percent surveyed cited using too much credit as a major factor in their decision to file for bankruptcy).

3/ Countryman, Vern, Improvident Credit Extension: A New Legal Concept Aborning? 27 Me. L.R. (1975)

4/ Id.

5/ Boyle, J., The Impact of State Interest Rate and Fee Preemption, Statement before the Subcommittee on Consumer Affairs of the House Banking Committee (October 6, 1981) at 17.

6/ Brimmer, supra n. 2 at 16.

considerably. Also, members of the post-war baby boom have entered and greatly expanded the 25 to 35 age group, which most frequently files for bankruptcy.[7/] Some believe that bankruptcies have increased because consumers have been made more aware of their rights through attorney advertising. To the extent that needy individuals are exercising their rights in greater numbers, this increase is desirable. In any case, factors other than the change in the law have played a significant role in the increase.

Before making hasty changes, we should acquire additional experience with the new law and a better understanding of the reasons for the increasing bankruptcies. Bankruptcy rates under favorable economic conditions also should be evaluated before acting to severely limit debtor remedies.

V. The Purdue Study Has Not Been Made Available For Peer Review

On October 6, 1981, Purdue University issued a press release describing a study its Credit Research Center had completed which found that "nearly 40 percent of Americans who filed for bankruptcy earlier this year could afford to pay half or more of their non-mortgage debt." When Consumers Union asked the Center for a copy of this study, we were informed that the report would not be available for review until after this hearing. CU finds it highly unusual that the University would issue a press release with such sensational information so long before its report would be available for peer review. In our view, the study is not reliable evidence for any proposition until it is available for review and critique.

Conclusion

In closing, Consumers Union urges this Subcommittee to reject the sweeping and ill-advised proposed changes in the eligibility criteria for Chapter 7. Debtors should not be forced to pay all income they earn in the future to pay off past, overwhelming debts. To amend chapter 7 in this way would, in effect, repeal it.

7/ Id. at 17.

PREPARED STATEMENT OF PROFESSOR VERN COUNTRYMAN

Mr. Chairman, I appear today, at the Subcommittee's kind invitation, to testify on a proposal for amendment of the Bankruptcy Reform Act of 1978.

I am a Professor of Law at Harvard Law School. I have taught bankruptcy law since 1946, save for a four-year period, 1955-1959, when I practiced law in Washington, D.C. I am also Vice-Chairman of the National Bankruptcy Conference, a nonprofit, unincorporated organization composed of bankruptcy judges, practitioners, and law professors who specialize in bankruptcy law, and two federal district judges who were formerly bankruptcy judges. The Conference at present consists of 58 regular members and 9 associate members and they come from all parts of the country.

I appear here today in my individual capacity and as a representative of the National Bankruptcy Conference.

The essence of the proposal before the Subcommittee, as I was advised by the Chairman's letter of September 30, 1981, is to bar from liquidation proceedings, under Chapter 7 of the Bankruptcy Reform Act, any individual who has filed a petition for relief under that Chapter and as to whom the bankruptcy court determines, on motion of a creditor to dismiss the petition, that the individual can pay "a reasonable portion of his debts out of anticipated future income." The effect of this proposal, as the Chairman's letter indicates, would be to restrict such individual to relief under Chapter 13 and there is also a proposal to extend the period of a Chapter 13 plan from 3 to 5 years.

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One of the current proposals is not new. Essentially the same idea for forcing debtors into old Chapter XIII (but without extending the period of the Chapter XIII plan to 5 years) was embodied in H.R. 292 in the 89th Congress and in H.R.1057 and H.R.5771 in the 90th Congress. A subcommittee of the House Judiciary Committee held hearings on the earlier proposals on May 24 and 25, 1967, at which time I appeared to testify in opposition to them on behalf of the National Bankruptcy Conference. Those proposals never emerged from the House Committee.

Essentially the same idea as lies behind the current and the earlier proposals was embodied in an even earlier proposal of almost half a century ago that we adopt the English practice of suspending bankruptcy discharges until the debtor had paid off, or at least substantially reduced, his existing debts from his future earnings. That proposal provoked vehement opposition in Congressional hearings --it is to my knowledge the only proposed bankruptcy legislation to be characterized by witnesses as "UnAmerican." Joint Hearings before Subcommittees of the House and Senate Judiciary Committees on S.3863, 72d Cong., 1st Sess., pp.546, 753 (1932). That proposal also never emerged from committee.

It is my position today, and that of the National Bankruptcy Conference, that the same fate should befall the current proposals.

The current proposals have been preceded by a number of newspaper accounts, usually larded with quotations from bankers and officers of consumer finance companies, to the effect that the Bankruptcy Reform Act, which took effect on October 1, 1979, has inspired a phenomenal increase in resort to bankruptcy by people who are in no need of

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bankruptcy relief because they are perfectly capable of paying their debts. But these claims have ignored the effect that the current state of our economy and the effect of the Supreme Court's decision in Bates v. State Bar of Arizona, 433 U.S. 350 (1977), permitting lawyers to advertise, might have had on increased bankruptcy filings. And they have otherwise been remarkably short on facts.

Last October 6, however, at a press conference in Washington, D.C., it was revealed that bankers and other consumer credit extenders had commissioned a $300,000 study of the matter through the combined resources of Opinion Research Corporation, Arthur D. Little, Inc., and Purdue University's Credit Research Center, and Professor Robert W. Johnson, Director of the Purdue Center, released some of the "findings" of that study to support the claims that:

(1) Personal bankruptcies totaled 409,000 in calendar 1980 compared with 228,000 in calendar 1979.

(2) Forty percent of those who filed for liquidation under Chapter 7 could afford to pay 50% or more of their non-mortgage debts over a 5-year period and 29% could have paid 100% of the debt over a 5-year period.

When I requested a copy of Professor Johnson's study, I received from him a set of tables, graphs, and charts that he used in his presentation to the press conference, but he advised me that he had no prepared remarks and that preparation of an actual transcript of what he said was still in process. I find in what he did send me virtually nothing to support his claims. I have the following difficulties with his data:

(1) There is a graph showing that the increase in bankruptcy filings is greater than the increase in

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unemployment. That is not surprising. You don't have to be unemployed to be in financial trouble in today's economy. Moreover, the graph is said to be based on information obtained from the Administrative Office of United States Courts on bankruptcy filings. Since Professor Johnson's data is on a calendar year basis and the information supplied to me by the Administrative Office is on a different basis, I cannot check Professor Johnson's figures precisely, but it appears that the situation is improving from the consumer credit extenders' point of view. Professor Johnson claims personal bankruptcy filing rose from 228,000 in calendar 1979 to 405,000 in calendar 1980. But from the data contained in the Administrative Office's Federal Judicial Workload Statistics for the year ending March 31, 1981 it appears that total personal Chapter 7 filings were 225,016. Finally, Professor Johnson's figures are inflated if he followed the Administrative Office's practice of double counting a joint petition filed by husband and wife as two bankrupt estates. (There were, in the year ending March 31, 1981, 152,017 such joint petitions.)

(2) Nothing in what Professor Johnson sent me contains a scrap of information to support his pronouncements about how many of hundreds of thousands of people could pay what percentage of their debts out of future income. But enough is revealed to disclose that Professor Johnson doubtless has no information to support his pronouncements. One of his tables reveals that his "data base" consisted of 2,249 bankrupts whose bankruptcy petitions were examined and that 1,199 had also been interviewed and credit reports on them had been examined.

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None of these sources, nor all of them combined, would yield any reliable information on what the income of the 2,249 debtors would be for the next five years, much less what would be the income for the next five years of the hundreds of thousands of debtors for whom Professor Johnson makes his sweeping predictions.

Other of Professor Johnson's charts, tables, and graphs indicate that what he has done is to assemble statistics (some from government sources and some for which no source is revealed) on average income, average expenditures, and average living expenses and then to extrapolate some conclusions about debtors who file Chapter 7 petitions--debtors who, whatever else they may be, are not average.

Mr. Chairman, as I went through Professor Johnson's stack of charts, tables, and graphs, I had a feeling that I had seen this sort of thing before. And I had, during my service in the Army Air Force in World War II. Air Force information officers in the field frequently compiled similar charts, tables, and graphs for the edification of higher headquarters. And the people who compiled such displays had a very accurate description for what they were doing: if you don't have hard facts, give them "eye wash."

So we are left where we started when the consumer credit extenders first began their orchestration of the attack on the Bankruptcy Reform Act some two years ago, with no factual basis for the assertion made in support of the current proposals that many debtors who could pay all or a substantial part of their debts are resorting to Chapter 7 proceedings instead. The consumer credit extenders

will get their $300,000 money's worth out of their eye-wash investment only if it enables them to persuade the Congress to enact their proposed solution for an alleged problem without any factual demonstration that the problem exists. Indeed, one newspaper account of Professor Johnson's press conference, which appeared both in The Washington Post and The Boston Globe, reports that Professor Johnson himself stated that he would hesitate to say that the bankruptcy laws permit widespread abuses.

Apart from a lack of factual support for the current proposals, our objections to them are four-fold:

(1) As said by a witness opposing the similar suspended discharge proposal almost fifty years ago, the current proposals are "contrary to the genius of our institutions" (Joint Hearings, supra, p.641). The Thirteenth Amendment provides that, except as a punishment for crime, involuntary servitude shall not exist in the United States. Acting under that amendment, the Congress long ago abolished peonage in the United States (42 U.S.C. §1984) and made it a crime to hold a person in a condition of peonage (18 U.S.C. §1581). In upholding the validity of those statutes, the Supreme Court defined peonage as "a status or condition of compulsory service, based on the indebtedness of the peon to the master. The basal fact is indebtedness." Clyatt v. United States, 197 U.S. 207, 215 (1904). The Supreme Court has also invalidated state peonage laws under the Thirteenth Amendment. Bailey v. Alabama, 219 U.S. 219 (1911); Taylor v. Georgia, 315 U.S. 25 (1942). Imprisonment for debt has also largely been abolished in the states. After three earlier experiments with a bankruptcy law that conditioned the debtor's discharge on creditor consent, we have rejected that

device in favor of an unobstructed discharge for the debtor who honestly surrenders his existing assets to his creditors. We would turn our backs on our history and our traditions if we were now to enact a mass peonage statute whereby the debtor's discharge is to be delayed for a 5-year period of bondage during which his future earnings are sequestered for the benefit of his existing creditors.

(2) The current proposals discriminate against individual, noncorporate, debtors. No similar provision is made requiring the owners of corporations to continue operations for a 5-year period in an attempt to provide enough income during that period to pay or reduce existing corporate debts. The individual debtor needs his discharge and if conditions are imposed on his receiving it, he must perforce attempt to meet the terms of the conditions in order to get it. But stockholders can walk away from the bankrupt corporate shell without fear of unpaid corporate debts for which they were never personally liable. As someone before me once said, a certificate of incorporation is, for the stockholders, a bankruptcy discharge in advance. In recognition of this fact, the Bankruptcy Reform Act of 1978 makes no provision for discharge of corporate debtors. See 11 U.S.C. §727(a)(1).

(I note in this connection what may be a technical error in the current proposals. They would exclude from Chapter 7 some individual debtors who are not eligible for Chapter 13 because they cannot meet the debt limitations of 11 U.S.C. §109(e)).

(3) Voluntary composition and extension agreements have been successfully employed as a common law device,

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under an 1874 amendment to the Bankruptcy Act of 1867, under §12 of the Bankruptcy Act of 1898, under Chapter XIII of the Chandler Act of 1938, and under present Chapter 13 of the Bankruptcy Reform Act. But an involuntary composition orextension agreement forced upon a debtor seeking relief under Chapter 7 can be expected to work about as well as compulsory marriage counseling for a spouse bent on separation or divorce. While voluntary compositions and extensions have worked under old Chapter XIII and present Chapter 13, they have been performed by debtors who, for whatever reason, come into Chapter 13 with some incentive to make them work. A debtor who is forced into Chapter 13 could not reasonably be expected to have the same incentive or to make the same effort to produce the earnings necessary successfully to perform the plan, particularly if he is to be subjected to the rigors of the plan for a period as long as five years.

(4) With individual debtors before them in individual cases, the bankruptcy courts, who are supposed to decide in each case whether the debtor can "pay a reasonable portion of his debts out of anticipated future income" over a 5-year period, will get no comfort or assistance from Professor Johnson's charts, tables, and graphs. And they will get no more comfort or assistance from the statements of present income and expenses, together with estimated future income and expenses for the next two years, which the current proposals would require the debtor to supply. Few debtors, I believe, can forecast their income and expenses in any

reliable fashion for a two-year period. And I have yet to talk to a bankruptcy judge who believes that he can do a better job of forecasting the debtor's future income and expenses over a five-year period.

Senator DOLE. We now have a panel of two gentlemen representing the judiciary—Judge Dean Gandy, president of the National Conference of Bankruptcy Judges, Oakland, Calif., and Judge Joe Lee, U.S. bankruptcy judge, Lexington, Ky., on behalf of the National Bankruptcy Conference.

I might say to the panel that just left that I may be submitting some questions, and hopefully they can respond to those questions for the record.

Judge Gandy?

STATEMENT OF JUDGE DEAN GANDY, PRESIDENT, NATIONAL CONFERENCE OF BANKRUPTCY JUDGES, DALLAS, TEX.

Judge GANDY. Thank you, Mr. Chairman. We do appreciate the opportunity to testify before this subcommittee on behalf of the National Conference of Bankruptcy Judges.

We would like to be as helpful as we can. We do have a problem in that we have 220 individual judges spread throughout the United States, and it is hard to get a consensus from them.

Senator HEFLIN. Except on retirement.

Judge GANDY. Yes, that is correct—but not even on that sometimes.

Senator DOLE. Is Mr. Rosenberger here?

Mr. ROSENBERGER. Yes, Mr. Chairman.

Senator DOLE. Maybe you would want to come forward too. You are an old hand around this committee. We are happy to have you.

[Mr. Rosenberger comes to the witness table.]

Judge GANDY. When Senator Dole's letter was sent to Judge Hughes of Oakland, our former president, it was fortunate that we did have our convention in Detroit scheduled 2 weeks later. So it was suggested that we duplicate the proposed language and submit it for a voice vote to the judges present at that convention.

There were 71 active judges present and 9 retired judges. We did submit it to a vote, and I would like to briefly report the results of that vote and the reasons advanced.

In both instances the judges felt that it would not be good policy to amend the Bankruptcy Code in the way suggested. As to the future earnings test, the first problem that the opponents of the amendment saw related to the deluge of cases that would be filed.

You must understand that we have the same number of judges in place that existed precode, and yet we have at least three times more business and more complicated business. So the system is strained at the seams.

The judges felt that, from a short-term standpoint, that this would be the largest individual item of filing ever seen in bankruptcy—namely, motions to dismiss because of the future income test—and that that would wreck the system.

Second, there were opponents who felt that the amendments were contrary to the basic bankruptcy idea that, when a debtor gives up all of his nonexempt property to the bankruptcy trustee, he is entitled to a fresh start, freed from the burden of his debts.

Third, there was the problem that has been previously discussed by witnesses—namely, how do you define future income. Future income obviously must relate to future expenses. This would require then the bankruptcy judge to establish the reasonable norm of society in reference to expenses.

What is the reasonable norm in reference to transportation, say? I am a fanatic on the energy crisis and up till recently drove a 1972 Chrysler. Does that mean that all bankrupts would have to drive low-priced cars, or would they have to take the bus? This is a very difficult problem. Therefore, the substantial majority voted against the amendment.

There were dissents. Certain judges felt that people should pay their debts out of future income if they could. One judge felt that objective standards could be established, such as 150 percent of the reasonable norm for a family of four established by the Government.

I personally, individually, would favor objective standards to some extent, but that was not the view of the majority of the judges.

As to the 60-month amendment, the judges felt, since 1322(c) does permit the bankruptcy court to have the discretion to extend the payout time from 36 to 60 months—which is presently the law—there was no reason to provide a 60-month plan arbitrarily for the debtor to follow. Therefore, there was a vote against that amendment.

The dissenters felt that 60 months might be appropriate, but in general the majority felt the 60-month amendment would not be. Those were the reasons.

I have briefly summarized my written statement and obviously have gone into a lot more in that written statement.

Senator DOLE. I have read the written statement. That will be made a part of the record.

Judge Lee, we will also make your entire statement a part of the record.

STATEMENT OF JOE LEE, U.S. BANKRUPTCY JUDGE, LEXINGTON, KY., ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

Judge LEE. I have submitted a written statement, Senator.

I did want to also identify myself as chairman of the Consumer Bankruptcy Committee of the American Bar Association as well as a bankruptcy judge.

It has been my observation, based on 20 years of experience as a bankruptcy judge including 2 years under the new law, that there is very little abuse of the bankruptcy process by debtors. I think the stories of abuse have been magnified out of all proportion to actual fact.

Also, I want to comment on Senator Heflin's statement in his opening statement that this $1.6 billion that would be recovered for creditors under a compulsory chapter 13 system would be passed

along to users of credit. I would like to point out that another study in which Dr. Johnson participated, in 1972, tends to refute that statement.

I am referring to the National Commission on Consumer Finance, which was created by title 4 of the Consumer Credit Protection Act, which was enacted in 1968. That provision required Congress to establish a commission to study the field of consumer finance, which was done, and their report was filed in 1972. One of the conclusions they came to was that there is almost no competition in the field of consumer credit, except in automobile loans.

You see, it is simplistic to say that this would be passed on to users, because interest rates in the consumer credit industry are fixed by State law. We have 50 State laws—small loan laws. In my State, the interest rate ranges up to 42 percent for small loan companies.

I simply do not believe that this recovery would be passed along in the form of reduced interest rates. As you know, interest rates for example are now fixed by the Federal Reserve System. They bear no relationship to bankruptcy or to use of credit in general. They are fixed to stop credit.

I think what we need to do is identify the problem. If you identify the problem as too many bankruptcies, then you tend to address it in the manner in which it is proposed to be addressed by this legislation. But if you identify the problem as too much consumer credit, then you might address the problem in a different manner.

In one of my handouts that I have submitted, I have shown that during the last 10 years, while we were working on bankruptcy reform, consumer credit increased by $275 billion. That is a staggering sum, and it represent all these revolving charge accounts in stores and credit cards.

At the time they laid out this $275 billion over the last 10 years, they knew that future earnings were not part of the debtor's estate in a bankruptcy case. Now, after extending that much credit, they have come to you to ask you to tighten the bankruptcy laws to help them collect what is probably a lot of improvident loans in that amount of credit.

I think you ought to take a hard look at that before you do it. Any sort of restriction on access to bankruptcy should be accompanied by a restriction on their rights, such as the abolition of garnishment entirely or a restriction on enforcement of deficiencies on repossession of items.

I do not think this is a one-way street. There has to be a balanced approach to this problem, because if they succeed here in tightening bankruptcy, then they will go to the States and try to tighten up the State collection laws, and the debtors' legal environment in the State will further deteriorate. I think this law that we enacted in 1978 has improved the legal environment of debtors in States in the form of exemptions and otherwise, and I would hate to see that trend reversed.

I think there were sound policy decisions behind almost every provision of the new bankruptcy code when it was enacted. I have participated in it for a long period of time.

For example, the exemption provisions which they would now change were based on recommendations of the National Conference of Commissioners on Uniform State Law. Even the consumer finance study which I just referred to recommended that there be no right to enforce a nonpurchase money lien on household goods, and the Uniform Exemptions Act makes the same provision. Congress picked it up, and now they want to change that provision. It was a sound policy decision then, and it is a sound policy decision now.

I would like to say, Senator Heflin, that chapter 13 originated in Alabama, even before the Chandler Act of 1938. I remember Congressman Hobbs—in reading the record—was a participant in that. He limited plans to 3 years, because he did not want debtors to be wage slaves.

Alabama has always had a lot of chapter 13 cases. In enacting the new code, we thought we made it attractive enough that it would catch on in other States, and it really has. I think the use of chapter 13 has almost doubled since enactment of the new code, and I do not think there has been sufficient time to see how much it will be extended to other States. I think it is a little early to pass judgment and ask for these changes.

Thank you.

Senator DOLE. Thank you.

Senator Heflin?

Senator HEFLIN. In Alabama, they claim that in Birmingham or Jefferson County for 25 to 30 years it worked pretty well—that it gave relief and the creditors got their money.

Judge LEE. Voluntarily it worked very well.

Senator HEFLIN. Of course we now have a Federal judge named Judge Allgood who was a Federal referee in bankruptcy at the time. He worked it out. The experience there was that it caused no real hardship on the debtors and eventually the creditors got their money. It is generally accepted as being an excellent thing.

Judge LEE. It really is catching on everywhere, Senator.

Senator HEFLIN. You have some rulemaking authority. You do not do too much with it though, do you? Has it ever been a very effective thing—the rulemaking body that is in the bankruptcy code? I have forgotten how it works. It has been so long since I have gotten into bankruptcies.

Judge GANDY. We do have the power, I believe, to enact local rules, Senator.

Senator HEFLIN. That is the worst thing in the world today in the Federal courts—the lack of uniformity. You have to hire an expert every time you go from one judge to another judge or from one district to another district. Is there any overall bankruptcy rulemaking authority?

Judge GANDY. I do not know of any in the bankruptcy area.

Senator HEFLIN. If we adopted something like this and tried to delegate some rulemaking authority on this sort of thing—you do not have anything other than local rules?

Judge LEE. The Judicial Conference prepares rules and recommends them to the Supreme Court. Then they are submitted to Congress, and then they are approved after a period of time. We are in the process of making new rules to conform to the code.

Senator HEFLIN. Is there a subdivision of that that works up rules?

Judge LEE. It is the Judicial Conference, and they have a rules committee that they have appointed.

Senator HEFLIN. They have all those district judges, and they do not pay much attention to bankruptcy.

Judge LEE. We have quite a number of bankruptcy judges, law professors, and some district and circuit judges on the Rules Committee. It is a pretty well balanced committee at the present time.

Senator HEFLIN. Again, I would like to ask your organization this. We are not prejudging or saying how this would come, but if you have legislative suggestions that ought to go into such a concept and language, we would like to see it, so we can weigh in the balance various provisions, and so we can at least get our staff working a little on the thing.

Judge LEE. It is my understanding that Professor Countryman in his statement submitted a recommendation of the National Bankruptcy Conference, which we believe would be an acceptable midway solution to this problem. It would not require compulsory chapter 13, but it would prohibit these 1 percent plans and 0 plans and that sort of thing by debtors who voluntarily take chapter 13 for some reason.

We think it would work, because it delays the discharge for 3 years, during which creditors may move to have the plan reconsidered at any point in time if they think the debtor's earnings have increased, but it is still a voluntary program which we think should be adhered to.

We are very concerned that denying access to chapter 7 to debtors would leave them prey to State collection laws, which we think would be tightened up considerably if there were no access to bankruptcy.

Senator HEFLIN. Let me mention one thing. I am getting a lot of complaints, maybe just from my own home State and maybe my judges, but I would assume it is a universal problem. I am getting complaints from lawyers and creditors about debtors saying some are coming to court and to meetings, and the day before some lawyer comes into the bankruptcy judge or trustee or somebody and says, "I've got a problem; let's continue the case." People come from hundreds of miles to get there, and they find out the case has been continued.

I do not know if there is a remedy for that, but I have run into it in my home State. There is a lot of waste of time of creditors and other people who come into a focal point, maybe 100 miles away, and when they get there they find out the case is continued. I do not know if there is any way you can notify people of that sort of thing.

I realize that there is sickness and other things, but I am getting an awful lot of complaints about it in my State and about the unnecessary travel that is occurring in regard to that.

Judge GANDY. That may relate, Senator, to the first meeting of creditors, and of course the U.S. trustee now is in charge of that.

Senator HEFLIN. That is probably most of it, but there are others too.

Judge LEE. I would say we are not generous in continuances. We try to adhere to the rigid schedule, because we know people will be inconvenienced if it is continued.

Senator HEFLIN. Thank you.

Senator DOLE. Thank you, Senator Heflin.

I want to thank the witnesses for their testimony. We will of course be in touch, depending on whether we pursue what has been suggested or whatever may happen.

Mr. Rosenberger, it is good to have you back in a familiar setting.

Mr. ROSENBERGER. Thank you, Senator. It is good to be back.

Senator DOLE. Thank you.

[The prepared statements of Judges Gandy and Lee and additional submissions for the record follow:]

PREPARED STATEMENT OF DEAN M. GANDY

Mr. Chairman, Members of the Sub-Committee, and Members of the Sub-Committee Staff. The National Conference of Bankruptcy Judges thanks you for extending to us the opportunity to submit our views in reference to the two proposals which are the subject of these hearings. I am the recently elected President.

Our organization is composed of substantially all of the Bankruptcy Judges of the United States, and its general objective is to improve practice in bankruptcy proceedings. In the future, to the extent that we can correctly and quickly ascertain the views of a majority of our members, we will be happy to attempt to comment on any different issue as to which you request our views.

When Sen. Dole's letter of September 30, 1981, addressed to our then-President, Judge Robert Hughes, was received, it was suggested that the letter be duplicated and distributed to all of the Bankruptcy Judges present at the annual convention of our association, which met in Detroit on October 11-14, 1981. This was done, and an active debate ensued among the judges on the issues submitted. Seventy-one active Bankruptcy Judges were registered for the convention, and nine former judges were also present. Practically all were in attendance at the business meeting on October 14, 1981, when these two issues were submitted on a voice vote.

The first issue as submitted was whether the Bankruptcy Code should be amended to deny the benefits of Chapter 7 to any individual who could "pay a reasonable portion of his debts out of anticipated future income". Although there were some dissenting votes, a substantial majority of the judges present voted <u>against</u> recommending that the present Code be so amended. The reasons advanced by the speakers for the majority were:

(1) Motions raising this issue could be expected to flood the Bankruptcy Courts. Those courts are now extended beyond all reasonable limits, and this added anticipated deluge could not be handled with justice and dispatch. As of this date, there are 220 full-time Bankruptcy Judges throughout the United

States, and nineteen part-time judges. This is about the same number of judges that handled the bankruptcy system before the Code became effective on October 1, 1979. In the fiscal year preceding the effective date of the Code, there were 226,476 bankruptcy cases filed throughout the United States. For Fiscal Year 1980, those numbers of cases filed had increased to 360,957, and for the year ending June 30, 1981, there were 519,063 cases filed. Even more significant, the number of adversary proceedings in bankruptcy cases has risen from a 42,600 annual rate based on the nine months' period ending June 30, 1980, to 94,632 proceedings for the year ending June 30, 1981. Projections for 1982 are for 122,000 adversary proceedings. Because of the expanded jurisdiction of the Bankruptcy Court, the type of adversary proceeding, particularly in the business area, has increased in complexity, and these proceedings represent some of the most complicated cases tried in the United States. The net effect of all of this is that the same system in place prior to the institution of the Code is handling a case load at least three times larger than pre-Code courts, and this is causing the system to be strained at all seams. The judges present in Detroit who followed this reasoning felt that motions raising the reasonable efforts issue would far exceed any other type issue ever submitted in a bankruptcy context, and would require extensive trials of highly complicated matters. If it could be anticipated that the court system could be expanded quickly to accommodate all of this added business, this might not be a valid objection, but none of the judges who spoke on this issue felt it could be accomplished except in a matter of several years. During that time interval, we feel the cases will have to be postponed, or given only a cursory look. If they are

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postponed, the debtor would have no relief, and if they are given only a cursory consideration, many errors could result.

(2) The addition of the reasonable efforts test is not consistent with the historic bankruptcy principle that a debtor, who has relinquished all of his non-exempt assets to the bankruptcy trustee, is entitled to a "fresh start" freed from the burden of his debts. The judges who advanced this argument felt that in bankruptcy, like all other areas of the law, there is room for abuse, but this is too radical a change in response to current problems.

(3) Determination of what is a "reasonable portion" of debts and what is "future income" could be highly speculative, would be applied in a non-uniform way throughout the country, and even between different debtors in the same court. What is a "reasonable portion" may very well relate to the identity of the creditors, and the circumstances under which the debts were incurred. For example, would debts generally owed to unsophisticated investors who innocently trusted the debtor require a larger percentage of payment than debts owed to lending institutions that used advertising tactics to secure the debtor as a customer? Would the existence of a large profit margin as to one creditor result in a different application of the rule than as to a creditor who had no profit at all? How is "future income" to be defined? Presumably, this means the excess of income reasonably anticipated in the future over reasonably estimated future expenses in view of the suggested amendments to §521. The extent to which any given item of expense differs from the reasonable norm will have a direct relationship to the net income remaining. This, then, requires the Bankruptcy Court to determine the reasonable norm for expend-

> itures in the community. What is reasonable, for example, for transportation? Should the debtor be required to always ride the bus? Is a 1980 large car reasonable, or should it be a small one, or should it be a 1975 model? Bankruptcy Courts have always been required to make difficult decisions, but the determination of the reasonable norm for expenses throughout a community applied to individual circumstances of despair or irresponsibility is mind-boggling.

The dissenting judges who spoke in favor of the reasonable efforts test being included in the Code cited cases in their courts where debtors could pay some portion of the debts in the future, and these judges felt the effort should be made to attempt to arrive at a standard to cause the payment of a reasonable portion of the debts out of future income. One judge felt that the standard should be an objective one, such as 150% of the government level estimated as a reasonable norm for a family of four throughout the United States.

The second issue presented at the Detroit convention related to the wisdom of amending §1322(c) of the Code to permit payments under a Chapter 13 plan without court approval for a period up to sixty months. This proposed amendment was also rejected by a substantial majority of the judges present. There were some dissents. The primary reason advanced by the speakers who opposed the amendment was the fact that the Bankruptcy Court now has the power to permit the debtor, for cause, to have a plan confirmed that provides for a 60-months payment. As long as the court has the discretion to extend the payment period from thirty-six months to sixty months, the judges did not feel that the law should be changed. Some judges felt that burdening a consumer debtor with an obligation in excess of three years to make payments on a plan was, as a general proposition, unreasonable, but the court should always have the power in a given case to extend the time for a period not longer than sixty months. The few dissenters who spoke in favor of the amendment did not consider a 60-months plan an unreasonable burden.

I believe the foregoing accurately represents the action that took place at our convention, and I will be happy to answer any questions that you may have.

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DEAN M. GANDY

MAILING ADDRESS
P.O. BOX 50103
DALLAS, TEXAS 75250

U.S. COURTHOUSE
1100 COMMERCE STREET
DALLAS, TEXAS 75242
214/767-0816

November 12, 1981

The Honorable Robert Dole
Chairman, Sub-Committee on Courts
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Senator Dole:

Thank you for your letter of November 2, 1981, giving additional time for any further language or imput on the future income amendment to Chapter 7 of the Bankruptcy Code.

As bankruptcy judges, we would like to be as helpful as possible to your committee as it attempts to resolve the difficult questions under consideration. You will recall I mentioned during my testimony the problems involved in getting any quick and accurate consensus from our members on these issues, and the fortunate timing of the Detroit convention. To the extent the present letter goes beyond my prior testimony, it represents my own personal views, and not those of the National Conference of Bankruptcy Judges, although I am sure my views are shared by many of my colleagues.

There may be reasons to change other substantive provisions of the new Code, particularly in the Chapter 13 area, but you will recall that the NCBJ, by a substantial majority, rejected the future income test in the Chapter 7 consumer area for the reasons I indicated. No amending language is therefore proposed. However, I personally would favor an objective test that would attempt to eliminate the very small number of Chapter 7 cases of individuals who have substantial income. Thus, I would add after your proposed language in proposed §109(f) the phrase "and could reasonably be expected to have a gross income in excess of $50,000 in the

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year following the order for relief." This would eliminate the rare case of the lawyer, doctor, or businessman who has the prospect of large income in the future, and whose case is normally the one who attracts sufficient publicity to discredit the entire system. Since I do consider these cases are only a small fraction of the total number of Chapter 7 cases filed by individuals, I see no reason why the arguments made by me as to all individual Chapter 7 cases would have the same validity. The $50,000 figure is arbitrary, and designed to exclude the average consumer debtor.

I agree with the NCBJ that there is no reason to change the Bankruptcy Code as it relates to the normal, consumer individual case. The key point to emphasize in this area is that <u>there is no basis for any conclusion that the increase in consumer filings is directly related to the change in bankruptcy law</u>. If there were significant differences between straight bankruptcy under the Act and Chapter 7 relief for the consumer under the Code, there might be some basis for this argument, and for the extensive newspaper publicity that assigns responsibility to the Code for the increase. Yet, there is no significant difference between consumer rights in straight bankruptcy under the Act and consumer rights in straight bankruptcy under the Code. There is no reason for a debtor to file under the Code when he did not file under the Act. The slight changes in the discharge provisions would certainly not justify the increase in filings. There was a significant difference in the addition of the federal exemption option, but since the vast majority of the states have now opted out of the federal exemptions, that change between the Act and the Code is no longer significant. Another possible difference could be the lien avoidance section (522f) that was added to the Code, giving the debtor a right not found in the Act. In Dallas, however, only a small percentage of the debtors use this right, and until it is determined nationwide what percentage of cases under Chapter 7 utilize §522f, this single difference between Act and Code is not conclusive to assign blame for the increase to the Code. If consumer debtors received no increased

rights under Chapter 7 of the Code, how can it be rationally argued that the Code is the culprit as to the increased filings? It is true that there were significant changes in favor of the consumer debtor if he elected to file under Chapter 13, the chapter which the consumer finance groups seem to prefer. The argument advanced for increasing the consumer debtor's rights under Chapter 13 during the eight years of deliberation that preceded enactment of the Code was to encourage debtors to file under Chapter 13 instead of Chapter 7. Thus, the consumer debtor received nothing more under the Code in Chapter 7 than he had under the Act.

I submit that the unfortunate increase in bankruptcy filings is the result of three factors that cannot be corrected by revisions in the Bankruptcy Code. The first factor is a basic change in the concept of moral responsibility as to debt payment in our society. Historically, in most societies, the debtor who could not pay his debts was given some form of relief if he elected to file a bankruptcy petition. During all of this time, society encouraged the debtor to file that petition only as a last resort, and only because there was no other way for him to be returned to the social group as a productive individual. There was a stigma attached to conceding defeat in his financial life, and particularly so if he took the bankruptcy alternative at too early a point in time. Similarly as to divorce, society encouraged compromise, and delay in taking the radical step of dissolving the marriage. There is little argument to the effect that the increase in present day divorce is explained by liberalized divorce laws, but instead it appears to be generally explained by a change in the thinking of the social group. Likewise, bankruptcy has lost much of its stigma, and the debtor is prepared to concede defeat at an earlier point in time than in the past. Our society emphasizes rights instead of responsibilities. Whether that change in moral inclination is right or wrong, and if wrong, as I personally think it is, how it can be corrected, is not, in my view, a fit subject for bankruptcy law reform.

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The second cause for the increase in bankruptcy filings, at least in Dallas, is directly related to lawyer advertising. Attached to this letter is an exhibit showing the increase in bankruptcy filings in the Dallas Division for Act and Code periods. There was no lawyer advertising under the Act, and lawyer advertising was insignificant even after the enactment on October 1, 1979, of the Code until June, 1980, when it suddenly mushroomed. Thus, Dallas furnishes an example of an increase in filing that did not occur under the Code until after extensive lawyer advertising. The advertising created a 288% increase in the comparable post-Code period before advertising.

I personally am of the opinion that some of the advertising relating to bankruptcy is deceptive. It is not merely price advertising, but indicates that a person burdened with debts has something of an easy out in the bankruptcy law. If it is true, as I am led to believe, that bankruptcy results in the loss or restriction of credit, then debtors should be made aware that the filing of the bankruptcy petition could have adverse consequences. As I understand Bates v. State Bar of Arizona, 433 U.S. 350, "...advertising that is false, deceptive or misleading ... is subject to restraint". (p. 383). The court also said at p. 384 that a "limited supplementation, by way of warning or disclaimer or the like, might be required of even an advertisement of the kind" covered by the Bates case "so as to assure that the consumer is not mislead." The consumer should perhaps be warned in a manner similar to cigarette advertising by the bankruptcy advertisers that the filing of a bankruptcy petition could result in the loss of credit. Yet, again, I fail to understand how this problem can be corrected by a bankruptcy statute. The Bates case related to violation of the First Amendment by the local bar association in prohibiting lawyer advertising. It is assumed that the exceptions the Supreme Court carefully enunciated would likewise relate to bar association action. Whether Congress, in the exercise of the police power, could or should impose those restrictions if bar associations do not, is not a subject with which I have any familiarity.

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The third factor causing an increase in filings is the adverse economic conditions that coincided with the nationwide increase, consisting of high unemployment, high interest rates, and an increase in inflationary pressures. Probably a majority of my fellow judges would list this as the first and primary factor for the increase, but I do not do so because the economic conditions in Dallas are not as severe as elsewhere, and the extremely liberal Texas exemption statutes result in very few cases in which a consumer debtor loses any property as a result of his filing. All he really gains is the elimination of creditor calls, suits, and contacts. This is not the case in most states.

These three factors are the reasons, in my opinion, for the increased filings, not the new Bankruptcy Code. The solution to the problem lies outside bankruptcy law reform.

Thank you again for giving us this opportunity to comment.

Very truly yours,

Dean M. Gandy
Bankruptcy Judge

DMG:jh

Enc.

cc: Mr. Doug Comer
Sub-Committee on Courts
Committee on the Judiciary
2204 Dirksen Senate Office Bldg.
Washington, DC 20510

Ms. Linda White, Chief Clerk (25 copies)
Sub-Committee on the Courts
2233 Dirksen Senate Office Bldg.
Washington, DC 20510

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TABLE OF CASES FILED IN THE
NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION,
UNDER STRAIGHT BANKRUPTCY OR CHAPTER 13
OF BOTH THE ACT AND THE CODE

Estates Filed Under The Bankruptcy Act

For the period July 1, 1977, through June 30, 1978	380
For the period July 1, 1978, through June 30, 1979	444
For the period July 1, 1979, through September 30, 1979, 118 consumer estates were filed, which, on an annual basis, would equal ---	472

Estates Filed Under The Bankruptcy Code Effective October 1, 1979

For the period October 1, 1979, through June 30, 1980 535 consumer estates were filed, which, on an annual basis, would equal ---	669
June, 1980 - Extensive lawyer advertising commenced in Dallas newspapers, and on television.	
For the period July 1, 1980, through June 30, 1981	1,928

NOTE: Under the Act, husband and wife cases were counted separately. Under the Code, they are counted as one case, but for this purpose, they are divided into two estates to show comparable figures. Consumer estates are assumed to be cases filed by individuals as distinct from cases filed by corporations or partnerships. There is no other data available to distinguish individual business cases from consumer cases. Traditionally, the vast majority of the individual cases do represent consumer cases. Note that the increase in cases on an annual basis after the effective date of the Code compared to the fiscal year under the Act ending June 30, 1979, was 151% before lawyer advertising, but after lawyer advertising, the increase between the annual rate filed under the Code before lawyer advertising and after lawyer advertising was 288%. Comparing cases for fiscal year ending June 30, 1979, to a full year after lawyer advertising indicates a 434% increase.

United States Bankruptcy Court
For the Eastern District of Michigan
Federal Building
600 Church Street
Flint 48502

CHAMBERS OF
Harold H. Bobier
BANKRUPTCY JUDGE

AREA CODE 313
234-5681, EXT. 234

October 27, 1981

The Honorable Robert Dole
United States Senate
Chairman Subcommittee on Courts
2233 Dirksen
Senate Office Building
Washington, D.C. 20510

Attention: Linda White
Chief Clerk

Dear Senator Dole:

In my letter to you dated October 26, 1981, concerning pending legislation before your committee regarding the Bankruptcy Code, I neglected to state that the views I expressed were confined to no other person except myself. I do not represent any other individual nor any organization, including the National Conference of U. S. Bankruptcy Judges. I would appreciate greatly if you would attach this statement to my letter of October 26, 1981.

Respectfully yours

Harold H. Bobier
U. S. Bankruptcy Judge

United States Bankruptcy Court
For the Eastern District of Michigan
Federal Building
600 Church Street
Flint 48502

CHAMBERS OF
Harold H. Bobier
BANKRUPTCY JUDGE

AREA CODE 313
234-5681, EXT. 234

October 26, 1981

The Honorable Robert Dole
United States Senate
Chairman Subcommittee on Courts
2233 Dirksen
Senate Office Building
Washington, D.C. 20510

Attention: Linda White
Chief Clerk

Dear Senator Dole:

Your letter of September 30, 1981, addressed to Judge Robert L. Hughes, President, National Conference of Bankruptcy Judges, was presented to the conference assembly at its annual meeting held October 12 - 14, 1981, in Detroit, Michigan. The letter went from your office to that of Judge Hughes in California and from his office to the president-elect, Judge Dean M. Gandy, Dallas, Texas. Because of the time strictures, except for a few officers, the members of the conference had its first exposure to your letter during the annual assembly and sufficient time was not available for a meaningful discussion of its contents.

Your letter directed attention to two proposed changes in the Code.

Proposal Number 1 would require the bankruptcy court to consider future earnings in determining eligibility for Chapter 7 relief.

Proposal Number 2 would raise the time limit on Chapter 13 plans from the present 36 months to a maximum of 60 months.

If I may paraphrase Proposal Number 1, a debtor, filing Chapter 7, and able to pay creditors under the protection of Chapter 13 and within its terms and provisions, would be denied relief under Chapter 7.

I support both Proposal Number 1 and Proposal Number 2.

As to Proposal Number 1, approximately 50% of those debtors who file for Chapter 7 relief, could successfully[V] conclude a Chapter 13 extension plan, that is, pay 100% of their debts.The ability of debtors to use a composition plan, i.e., pay creditors less than 100% of their accumulated debts would increase the percentage of feasibility of Chapter 13 substantially. You will recall that under the Act a debtor in Chapter XIII choosing a composition would still be charged with a six year discharge limitation which discouraged all but a few Chapter XIII debtors from electing to pay their creditors in part. Under the Code, a Chapter 13 debtor can use a composition plan without suffering the loss of his right to go into a Chapter 7 liquidation within the ensuing six year period. Consequently, there should be little reason, other than the desire to not pay creditors something, to deter wage earner debtors from choosing Chapter 13, either extension or composition, rather than Chapter 7 liquidation.

The present federal exemption statute creates a climate where many debtors can and do file a Chapter 7 purely for financial advantage. Example: Presently pending before this Court is a Chapter 7 case involving a single debtor, no dependents, who lists as his only asset a bank account of $17,000 which he claims as exempt property. One week before the debtor filed his bankruptcy petition, he transferred $7,500 to his father to pay an antecedent debt.

The trustee brought an action to set aside the $7,500 transfer as a preference, and also challenged the claimed exemption relating to the $17,000 cash on hand.

The facts leading to the above case are as follows:

> The debtor, a young man, received an injury to his knee, not work related. He sued on an insurance policy which he claimed covered his injury and netted, after all costs including attorney's fees, $27,500 in judgment.
>
> The debtor claims the personal injury recovery is exempt property and the payment to his father is not a preference as the whole recovery would be exempted from the estate.

[V] The figure of 50% was arrived at in a seven month study made from the records of this Court and a personal interview with each bankrupt who had filed a Chapter 7 petition in this Court during the preceeding seven month period. The study was made by Robert Dolphin, Michigan State University, and published in the Michigan State University's Bureau of Business and Economic Research, in June 1965. Dolphin interviewed 482 persons who filed bankruptcy during the study period and concluded that 49% of those who filed straight bankruptcy could have paid off their debts by filing Chapter XIII of the Bankruptcy Act. The results of the study were published in book form and distributed under the title of "An Analysis of Economic and Personal Factors Leading to Consumer Bankruptcy", Thesis for the Degree of D.B.A. Michigan State University, Robert Dolphin, Jr., 1964. To the writer's last knowledge, Mr. Dolphin was a professor at Florida State University, Tallahassee, Florida.

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If the debtor's stance is mandated by law, the creditors would get zero on their claims against him.

Subsequent to his judgment in State Circuit Court, the debtor resumed his employment with General Motors Corporation at prevailing high wages.

As I perceive the proposed legislation, the Court would consider the windfall to the debtor in addition to the future earnings available to him in determining his eligibility for Chapter 7 relief.

The above set of circumstances is unusual, but repeated many times, usually in lesser degree. Creditors understandably become angry when it is obvious to them that the debtor could pay on his debts if he had the desire to do so. Businessmen as well as non-business citizenry generally have a more or less general opinion that bankruptcy court could require debtors to pay something to their creditors but choose not to do so. It serves little purpose to advise creditors and others that the Court's powers are limited by Congress. The proposed legislation, if enacted, would serve to make the bankruptcy court more meaningful to consumer creditors and raise the Court in the public's esteem. Probably the least important, but nonetheless a consideration which should be valued, it would remove the discouraging aspect to the Court of presiding over a case where the debtor should be paying at least some of his debts and being powerless to do nothing about it.

The proposal is referred to, I believe, in the courts of Canada as a "conditional discharge", where it has been a part of the bankruptcy law for many years.

I do not believe that the proposal would impose, given a little additional help (perhaps one clerk) a lasting attrition on the Court's time, as any Court with Chapter 13 statistics to turn to, could devise a schedule of payments which debtors could make based upon income, amount of debts, dependents, classification of debts, etc. This approach is common to domestic relation courts in setting child and spouse support. Attorneys engaged in wage earner bankruptcy relief would soon learn when it would be fruitless to file a Chapter 7 in cases where the debtor could pay something to his creditors and hence the accelerated court time would lessen within a reasonable period of time.

As to Proposal 2, a substantial number of Chapter 13 debtors are buying their home, and experience has taught us that the debtor has usually a substantial arrearage in payments when he files his petition. Usually it takes up to sixteen months to liquidate the arrearage, and the usual plan approved in the Court over which I preside provides for payment of current mortgage payments plus a specific amount per month on the arrearage which will bring the contract current near the end of the plan. Sixty months would allow greater flexibility to the debtor in dealing with secured creditors and protecting his equities.

In order to provide some credibility for conclusions I have drawn in the foregoing letter, please let me state that I have presided over the bankruptcy court here in Flint, Michigan since September 6, 1961. During that time, I have handled a total of 6,837 Chapter 13 cases through September 1981. During that period of time, we have paid, net to creditors, eighteen million seven hundred and forty-five thousand six hundred eighty-one dollars and eighty-four cents ($18,745,681.84), and by the end of 1981 our net payment to creditors will exceed twenty million dollars.

I think the proposed legislation would be a very valuable addition to the Code.

Respectfully yours,

Harold H. Bobier

Harold H. Bobier
U. S. Bankruptcy Judge

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United States Bankruptcy Court
District of Utah
U. S. Courthouse
Salt Lake City, Utah 84101

Ralph R. Mabey
BANKRUPTCY JUDGE

November 9, 1981

Telephone: (801) 524-5158
FTS: 588-5158

The Honorable Robert Dole
Chairman, Subcommittee on Courts
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Dole:

As you know, your letter of September 30, 1981, to the President of the National Conference of Bankruptcy Judges inquiring as to the Conference's position respecting a proposed amendment to the Bankruptcy Code was acted on at the Conference's annual meeting in Detroit. The Conference disapproved the proposed statutory language (which I have attached to this letter) and Judge Gandy, one of my most distinguished colleagues, has since given testimony before your subcommittee on this matter, I believe.

While the position of the members of the National Conference of Bankruptcy Judges who considered the matter in Detroit, of course, warrants much greater weight than my individual view, I believe it appropriate in light of your inquiry to state my qualified support for the proposed language.

I believe the proposed amendment would not impose insurmountable practical barriers to the administration of justice in the bankruptcy courts. As explained in the decision of In re Iacovoni, 2 B.R. 256, this court, as have many others, determined that the present provisions of Chapter 13 require the debtor to pay a reasonable portion of his debts out of anticipated future income. This court has now had a good bit of experience deciding whether a Chapter 13 debtor on specific facts indeed could pay a reasonable portion of his debts out of anticipated future income. It is true that the court has of necessity adopted certain rules of thumb in order to expedite the process absent unusual circumstances. But the process has worked fairly smoothly.

The proposed language would require the court to make this same determination where a Chapter 7 petition was promptly challenged by a creditor. I believe that after a shakedown period, debtor and creditors' counsel would become generally familiar with the court's judicial gloss on "reasonable portion" and the initial additional burden placed upon the court by this enactment would decrease somewhat. It is probable, it seems to me, however, that even after a shakedown period, different standards of reasonableness would develop in different regions of the country as has occurred under the present Chapter 13 with those courts which require reasonable payments: some start at 70 percent pay back as presumptively reasonable, others at 10 percent. Certain debtors may also be expected to juggle their budgets in order to skew the judicial results. Like the tax laws, where hundreds of thousands of individuals are required to comply with bankruptcy provisions, one will not be able to expect discovery of all impropriety by the administrative or judicial system. I should also think that dischargeability complaints and reaffirmation issues will not decline under this amendment since creditors in my brief experience under the present code often seeks relief against consumers without much concern to their ability to

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pay. I would further note that the proposed language should include a corresponding amendment of Section 109(d) in order to avoid unintended effect upon Chapter 11.

Naturally, since the proposed amendment would markedly alter bankruptcy policy in place for nearly a hundred years, unforeseen legal issues will arise for interpretation by the courts. Nevertheless, I reiterate my belief that there is no insurmountable practical barrier to the implementation of this amendment.

The wisdom of the social policy which underlies the proposed amendment is, I recognize, a matter which the Congress is peculiarly well-suited to determine on its own. I would simply say that I think there is merit to the social policy implicit in the proposal.

Very truly yours,

Ralph R. Mabey
United States Bankruptcy Judge

RRM/bh
cc: Hon. Orrin G. Hatch
Enclosures

PROPOSED LANGUAGE

Section 2

(a) Section 109 of title 11, United States Code is amended by adding the following subsection:

"(f) An individual may be a debtor under chapter 7 of this title only if such individual cannot pay a reasonable portion of his debts out of anticipated future income."

(b) Paragraphs (2), (3), and (4), of section 521 of title 11, United States Code, are renumbered as paragraphs (3), (4), and (5), and a new paragraph (2) shall be added as follows:

"(2) If the debtor is an individual, file a statement of income and expenses setting forth (A) the debtor's current income; (B) an estimate of the debtor's current expenditures for living expenses and the support of his family; (C) all income which the debtor reasonably expects to receive within the two years following the petition; and (D) all expenditures which the debtor reasonably anticipates he will have to make within the two years following the petition which are not included in subparagraph (B) above."

(c) Section 342 of title 11, United States Code, is amended by adding the following sentence:

"The notice shall include a copy of the statement of income and expenses specified in section 521(2)."

(d) Section 305 of title 11, United States Code, is amended by adding the following subsection:

"(d) The court may dismiss a case under chapter 7 of this title upon the motion of any party in interest made not later than 30 days after the meeting of creditors, and after notice and a hearing, if the debtor is ineligible for relief under the provisions of section 109(f)."

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EFFECTS OF PROPOSED LANGUAGE

1. Use of Future Income	Debtor is not eligible for chapter 7 if a reasonable portion of debts can be paid out of future income.
2. Effect on Debtors Who Can Pay Some Debts Out of Future Income	Debtor is not eligible for chapter 7 relief. Debtor may use chapter 13.
3. Effect on Debtors Who Cannot Pay Any Debts Out of Future Income	No change from present Code. Debtors will file chapter 7 petition, and all debts will be discharged.
4. Impact on Bankruptcy Filings by Persons Filing Bankruptcy Petitions Under Current Law	
(a) Clear ability to pay	Probably will not file. Creditors will object. Petition will be dismissed.
(b) Some ability to pay	Probably will file chapter 13.
(c) Marginal ability to pay	Some will file chapter 13, but many will file chapter 7. Limited ability to pay will make creditor objection unlikely because of low potential return.
(d) No ability to pay	Will file chapter 7.
5. Treatment of Noncontractual, Business and Tort Debts	Affects all debts.
6. Procedure	Debtor files petition, and creditor must move to dismiss. Court not involved unless a motion to dismiss is made, and then, court only determines whether debtor has ability to pay debts out of future income.
7. Impact on Dischargeability Complaints and Reaffirmation Issues	May be expected to decrease because these involve attempts to reach future income. Debtors with substantial future debt paying ability will not be able to use chapter 7, so there will be less need for proceedings seeking to reach such income.
8. Post-Petition Change in Circumstances	Debtor denied relief can file new chapter 7 petition if circumstances change.
9. Effect on Court Process	Invites more extensive use of chapter 13. Will reduce filings as to those having ability to repay.

Prepared Statement of Judge Joe Lee

Mr. Chairman: I am Judge Joe Lee, U. S. Bankruptcy Judge for the Eastern District of Kentucky. I have served as a bankruptcy judge 20 years - 18 years under the Bankruptcy Act and two years under the new code. Coincidentally, I am also Chairman of the Consumer Bankruptcy Committee of the American Bar Association.

I understand that at today's hearings we will concentrate on two proposals in the so-called Bankruptcy Improvements Act of 1981 - (1) A proposal to restrict access of individual debtors to relief under chapter 7 of the code and thereby force them to seek relief under chapter 13 or, in the alternative, to dismiss the case and leave them to the prey of the full range of collection tactics of over-zealous creditors, (2) To require all chapter 13 plans to be five year plans unless unsecured creditors can be paid 70 per cent of their claims in a shorter period.

For fear that restricting my comments to these proposals might be interpreted as approving other provisions of the Bankruptcy Improvement Act of 1981 which are equally objectionable, in my written statement I have discussed the proposed bill section by section. I am able to endorse only one section of the bill, section 10, which clarifies the effect of a discharge with respect to the right of a creditor to enforce a lien which has not been avoided, and even this section probably has been rendered unnecessary by case law recognizing the right of creditors to enforce liens after entry of the discharge in bankruptcy.

It seems to me highly inappropriate, and smacking of rank opportunism, for the consumer finance industry to attempt to utilize the downturn in the economy, which coincided with the effective date of the new Bankruptcy Code, as justification for sweeping changes in the substantive law and court procedures, ignoring the sound policy decisions that were the basis of a law so recently enacted by Congress. I am especially appalled at a bill which detracts from the dignity of the bankruptcy court and imposes on and demeans the judicial function of the court without any opportunity for judges of the court and the Judicial Conference

to evaluate the enormous cost and waste of judicial manpower inherent in such proposals.

It is suggested as a basis for these proposed changes that individual debtors are abusing the provisions of the new Bankruptcy Code by seeking relief under chapter 7 when they could just as well pay their debts in a plan under chapter 13. Based on 20 years experience as a bankruptcy judge, including two years administering the new law, I find no basis for the contention that the new law is being abused. In fact, it is my belief that there are now fewer individual bankruptcies in relation to consumer credit outstanding than there were ten years ago.

I direct attention to hearings held October 1, 1969 before Subcommittee No. 4 of the House Judiciary Committee, which was then considering Senate Joint Resolution 88, 91st Cong., 1st Sess., to establish a commission to study the Bankruptcy Laws of the United States. Senator Quentin N. Burdick, who was then chairman of the Subcommittee on Improvements in Judicial Machinery of the Senate Judiciary Committee, appeared as a witness at a hearing before Subcommittee No. 4 and presented remarkable statistics concerning the increase in consumer credit that had occurred in the 30-year period from 1939 to 1969.

From 1939 to 1969 the population of the United States increased from about 130.5 million to 202.3 million. On an index of 100, that was an increase to 155.

During the same period bankruptcy case filings increased from 50,997 to 184,930. On an index of 100 that was an increase to 363.

However, the population explosion and the bankruptcy boom paled in significance in comparison to the increase in consumer credit. Total consumer credit outstanding increased from 6.4 billion in 1939 to 112.8 billion in 1969. On an index of 100 that was an increase to 1772.

The increase in consumer credit was 10 times greater than the increase in population and 5 times greater than the increase in bankruptcies.

The glut of consumer credit has continued. In 1969 consumer credit outstanding hovered at the 100 billion dollar mark.

During the decade of the 70's, while bankruptcy law reform was in process, consumer credit increased an additional 274 billion dollars.

In December 1980 consumer credit outstanding reached 386 billion dollars.

The 1980 census fixes the population of the United States at 224 million.

During the 12-month period ending December 31, 1980 there were 331,098 bankruptcy cases filed.

I am not a statistician but it appears to me from these figures that the number of bankruptcy cases commenced in relation to consumer credit outstanding has decreased substantially and is less now than in 1969. In 1969 there was one bankruptcy case for every $610,230 of consumer credit outstanding. In 1980 there was one bankruptcy case for every 1.2 million dollars in consumer credit outstanding.

Statistics maintained by the Administrative Office of the United States Courts have contributed to the confusion concerning the increase in bankruptcy filings. The Code, unlike prior law, permits spouses to file a joint petition in liquidation as well as in chapter 13 cases. In order to correlate statistics on cases filed under the Code with statistics on cases filed under the Act the Administrative Office of U. S. Courts portrays a single case filed by a husband and wife as two estates. This inflates statistics concerning filings, especially as an indication of creditor losses, because generally speaking the debts owed by husband and wife debtors in a joint case are identical.

More husband and wife cases are filed under the Code, possibly because there is no longer any advantage to withholding filing for the wife. Under old law, if only the husband filed, the trustee could not readily liquidate the interest of the nonfiling spouse in property held by the parties as a tenant in common, joint tenant, or tenant by entirety. If only one spouse filed, property held in such manner was screened from the claims of creditors. There was a tactical

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advantage to filing for only one spouse. This tactical advantage has been substantially eliminated by the Code because the trustee can now liquidate the interest of the nonfiling spouse in jointly owned property. Consequently, we now have more joint petitions than under old law. But this does not mean creditor losses are greater, because creditors could seldom collect from the nonfiling spouse under old law.

Obviously statistics concerning the increase in bankruptcy filings should not be compared to filings in previous years without considering other relevant variables such as the increase in population, in consumer credit outstanding, and in the number of joint petitions being filed.

Section by Section Analysis of
Proposed Bill and Comments on Each Section

Sections 2 and 3 of the bill amend section 109 of the Bankruptcy Code to add two new subsections. One subsection denies access to chapter 7 to an individual debtor if it is found that such debtor can reasonably repay a portion of his debts out of anticipated future income. Upon such a finding, the debtor must agree to a period of involuntary servitude for five years or otherwise have the case dismissed and become subject to self help repossessions by secured creditors and repeated wage garnishments by unsecured creditors. No guidelines are suggested for the court to follow in determining whether an individual can pay a reasonable portion of his debts out of anticipated future income. For example, will the court be permitted to pass on the debtor's life style and insist that the debtor move to a low rent district or move closer to his place of employment to reduce expenses in order that the debtor may by able to pay creditors? This proposal in effect converts the bankruptcy court into a collection agency at the expense of the debtor and taxpayers and at no expense to creditors. This proposal is not unlike the discredited bankruptcy systems in effect in England and Canada.

Section 4 of the bill would drastically change section 341 of the Bankruptcy Code, which now precludes the bankruptcy judge from

presiding at or attending the meeting of creditors. Under the changes proposed in section 4 of the bill, the bankruptcy judge would be required to convene the meeting of creditors in any case involving a consumer debtor under chapter 7 or chapter 13 of the Bankruptcy Code and to "adjudicate any matters appropriate for resolution." This proposal completely alters the philosophy of the Code with respect to the noninvolvement of the bankruptcy judge in nonadversarial matters. If the proposal is adopted, the efficiency of the bankruptcy courts will be reduced in staggering fashion, again at the expense of debtors and taxpayers and with almost no benefit to creditors. For example, in my district I ride circuit and hold court at six different locations. Under present law, a clerk or deputy clerk can conduct meetings of creditors at two or more places of holding court while I am conducting trial at another location, all on the same day. This enables the court to hold meetings of creditors promptly after a case is filed and, at the same time, permits the judge to devote the major portion of his time to trial of contested matters. If the judge is required to be present at the convening of creditors, it will no longer be possible to conduct meetings concurrently at several places of holding court.

It may be anticipated that, in order that the judge not be required to repeat instructions with respect to the effect of the discharge in each individual case, a substantial number of meetings of creditors will be scheduled at the same time in order that such instruction may be given to debtors en mass. But when the instruction is concluded and the court withdraws, there is likely to be a complete lack of decorum as the examination of debtors proceeds. A large number of attorneys, debtors, and creditors interested only in a single case will have to sit through the examination of individual debtors in cases in which they have no interest. Typically, an attorney for a debtor will have to anticipate spending an entire morning, or perhaps an entire day, in the bankruptcy court in order to participate in the examination of a single debtor. This is bound to increase the attorneys' fees for debtors and creditors and will reflect adversely on the efficiency and decorum of the court. As

previously indicated, I presided over meetings of creditors under old law for 18 years, and there were almost never matters appropriate for resolution to be adjudicated by the court at such meetings. An enormous waste of judicial time is involved in requiring bankruptcy judges to preside, or even to convene, such meetings. It is unlikely that the court could conduct other business on the several days each month on which such meetings would be calendared.

Section 5 of the bill amends section 342 of the Bankruptcy Code concerning the notice to creditors, to require that the notice include a copy of the statement of income and expenses required to be filed by each individual debtor under the amendment made to section 521 of the Code by section 7 of the bill. This means that every notice to creditors will require inclusion of a photocopy of the income and expense statement filed by the debtor. The photocopying costs, the additional clerical help that will be needed to carry out this duty, and probably the additional expense of mailing such a statement will be enormous. A sufficient number of copies of the statement will have to be filed by each debtor, or the clerical staff of the court will have to prepare the necessary copies of the statement, and these statements will have to be stuffed in envelopes for mailing, again all at the expense of the debtor or taxpayers. This notice requirement will pretty well eliminate any possibility of saving any money by computerizing notice to creditors, as is presently being planned by the Administrative Office of the United States Courts.

Section 6 of the bill amends section 506 of the Code to establish a fixed method of valuing consumer goods for purposes of determining the amount of the allowed secured claim of a creditor in a chapter 13 case or in a chapter 7 case in which the debtor seeks to redeem property from the lien of such creditor. The value is fixed at the greater of an established resale market price or the original purchase price reduced at the rate of 12.5 percent per year or 1.04166 percent per month. (100 divided by eight equals 12.5 percent per year or 1.04166 percent per month).

This proposed change places the court in an unrealistic strait-

jacket in valuing consumer goods for the purpose of allowing claims. For example, under this proposal, if the debtor purchased household goods valued at $2,000.00 and one year later these household goods are damaged by fire, so that they have no resale value, the claim of a creditor holding a security interest in such household goods would have to be allowed as a secured claim in the amount of approximately $1,750.00 whereas under present law the claim would be allowed correctly as an unsecured claim.

Section 7 of the bill amends section 521 of the Code to add to the duties of the debtor a new requirement that an individual must file with the petition a statement of income and expenses setting forth -

(1) the debtor's current income,

(2) the debtor's current living expenses for support of himself and his family,

(3) all income which the debtor reasonably expects to receive in the next two years, and

(4) all expenditures which the debtor reasonably expects he will make in the next two years.

This is the statement which the staff of the court must duplicate and mail to all creditors, along with a notice of the meeting of creditors.

We doubt that any individual can predict with any degree of accuracy the expenditures he will make in the next two years.

This section of the bill also requires that within 10 days after filing a petition an individual must inform creditors secured by an interest in property of the estate of the debtor's intention with respect to retention or surrender of the collateral. This requirement is somewhat amusing when juxtaposed to the proposal in the previous section of the bill, section 6, under which the depreciation rate of such collateral would be fixed at one percent per month. If the proponents of this bill concede that their collateral depreciates at such a minimal rate, they hardly make a case for precipitously forcing the debtor's hand with respect to retention or surrender of the collateral.

Section 8 of the bill would abolish the minimum uniform exemptions now set forth in section 522(d) of the Code and

proposes a return to the pre-Code system under which exemptions were determined by the law of the state in which the debtor had maintained his residence for the requisite period prior to the filing of the petition. This proposal represents a complete change of position from the position taken by the consumer finance industry at hearings before the House and the Senate in 1975 and 1976 when bankruptcy reform legislation was under consideration. At these hearings Alvin O. Wiese, Jr., Esq., chairman of the Subcommittee on Bankruptcy of the Law Forum of the National Consumer Finance Association, stated as follows:

> The National Consumer Finance Association subscribes to the position of the Commission that exemption laws for the purpose of bankruptcy throughout the United States should be uniform. Traditionally, and under present law, the determination of the nature and amount of property necessary to afford a debtor a "fresh start" following a bankruptcy proceeding has been left to the discretion of state legislatures. Through the passage of time, and the legislative process, each state has its own exemption standards, some generous and some far too meager to enable a bankrupt debtor to commence the rehabilitative process. Section 4-503 of the Commission's proposed Act establishes uniform exemptions to be used throughout the United States in the Bankruptcy process. They appear to be liberal, but fair. In our opinion, uniformity is necessary to prevent "shopping" for a bankruptcy forum, and in those states with low and antiquated state exemption laws it is desirable to raise the standards to facilitate the rehabilitative process or "fresh start" which the Commission emphasizes as its theme. Conversely in those states with excessive exemptions, the attractiveness to the debtor of the bankruptcy process will be reduced and the Commission's objective of controlling the number of consumer bankruptcy filings will be aided.

Hearings before the Subcommittee on Improvements in Judicial Machinery of the Committee on the Judiciary, United States Senate, 94th Cong., 1st Sess., on S. 235 and S. 236, Part 1, February 19, 20; March 12, 13; April 16, 17, 24, 1975.

Section 8 of the bill also proposes to abolish the right of the debtor to avoid nonpossessory, nonpurchase-money liens on household goods, tools and health aids.

The right of the debtor to avoid such liens is included in section 522(f) of the Bankruptcy Code as a result of the recommendation of the National Commission on Consumer Finance and the National Conference of Commissioners on Uniform State Laws. The National Commission on Consumer Finance, established by title IV of the Consumer Credit Protection Act of 1968 (Public Law 90-321) included three members appointed by the president, one of whom was

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Robert W. Johnson of Purdue University; three senators; and three congressmen. The senators who served on the Commission were Hon. John Sparkman of Alabama, Hon. William Proxmire of Wisconsin, Hon. William E. Brock of Tennessee, and, later, Hon. John G. Tower of Texas. The Commission recommended as follows:

> A creditor should not be allowed to take other than a purchase money security interest in household goods.
>
> A creditor should be able to take a security interest in goods which form the basis of the transaction, but security interests in household goods should not be allowed in any loan or consolidation transaction if the goods were not acquired by the use of that credit. In the event of default, such security interest in household goods and the accompanying right to repossess or threat to repossess such goods have far too disruptive an impact on the family life of the debtor to be in the public interest.

See Report of the National Commission on Consumer Finance, December, 1972, page 27.

The Uniform Exemptions Act drafted by the National Conference of Commissioners on Uniform State Laws and by it approved and recommended for enactment in all states, and which was approved by the American Bar Association at its meeting in Chicago, Illinois, August, 1977, provides in section 11 that a creditor may not enforce a nonpossessory, nonpurchase-money security interest in health aids, household furnishings and appliances, wearing apparel and tools of the trade. Section 522(f) of the Bankruptcy Code, providing for avoidance of such liens, is based on this recommendation contained in the Uniform Exemptions Act.

It should be further noted that the courts of two states, New York and Pennsylvania, have held such security agreements to be unconscionable and therefore unenforceable. See New York v. Avco Financial Serv. of N. Y., Inc., 418 N.Y.S.2d 52 (App. Div., 1st Dept., 1979), and Beneficial Consumer Discount Co. v. Hamlin, 398 A.2d 193 (Pa. Super. 1977).

The suggestion that Congress should by legislation render enforceable contracts which the courts have declared unconscionable and which the National Commission on Consumer Finance and the National Conference of Commissioners on Uniform State Laws have recommended be unenforceable as against public policy should be viewed with considerable care.

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Section 9 of the bill broadens the fraud exception to discharge contained in section 523(a)(2) of the Bankruptcy Code to include any debt for obtaining money, property, services, or an extension, renewal, or refinancing of credit, by "false credit history, or falsification of other facts reasonably related to the debtor's incurring liability for the debt . . . ."

This section of the bill also amends section 523(d) of the Code to restrict the power of the court to assess attorneys' fees against a creditor that files an objection to dischargeability of a debt based on the fraud exception to discharge and fails to sustain the objection. Present law permits the court to assess attorneys' fees incurred by the debtor in defending the objection as a means of discouraging the filing of frivolous objections. Section 9 of the bill would change the law to permit assessment of such attorneys' fees only on a finding that the proceeding was not brought by the creditor in good faith.

Section 9 of the bill also proposes to establish a presumption that any debt incurred by a debtor within 90 days of the filing of the petition is fraudulent and not dischargeable under the fraud exception to discharge contained in section 523(a)(2) of the Code. The expense of rebutting this presumption, which in many instances would exceed the amount of the debt, is placed upon the debtor. Under this proposal a $50.00 dental bill for treatment of a toothache will be nondischargeable unless the debtor files a pleading asking that the debt be found to be dischargeable and unless the court holds a hearing and determines that the debt was not incurred by fraud. This is an unprecedented imposition on debtors and on the court.

Section 10 of the bill proposes to amend section 524(a) of the Code to clarify the effect of a discharge with respect to the right of a creditor to enforce a lien that has not been avoided. That proposal standing alone is unobjectionable. However, section 10 also proposes to abolish the discharge/reaffirmation hearing and to substitute therefor a requirement that the court inform the debtor of the nature and effect of a discharge at the meeting of creditors. This section of the bill also abrogates the requirement of court approval of reaffirmation agreements and substitutes

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therefor an extension of the period during which the debtor may rescind such an agreement from 30 days to 60 days after the entry of the discharge in bankruptcy. I have previously commented on the inadvisability of requiring the bankruptcy judge to convene the meeting of creditors as a trade off for abolishing the discharge hearing.

The Commission on Bankruptcy Laws recommended that no reaffirmation agreement be enforceable after bankruptcy. This recommendation was softened by permitting reaffirmations subject to court approval. Section 10 of the bill would in effect return to unpoliced reaffirmations as was the situation under former law.

Section 11 of the bill proposes to amend section 547 of the Code to reinstitute the requirement that it must be established that a creditor who receives a preference must have had reasonable cause to believe that the debtor was insolvent at the time of the transfer of money or property to such creditor before the transfer can be avoided as a preference. This would be in effect a return to a status of the law with respect to preference that prevailed prior to enactment of the Code.

Section 12 of the bill is a conforming amendment necessitated by the amendment to section 521 of the Code dealing with the duties of the debtor.

Section 13 of the bill must be considered in connection with the proposed amendment in section 8 of the bill, which would abolish the right of the debtor to avoid nonpossessory, nonpurchase-money liens on certain types of consumer goods. It is proposed that as a substitute for the right to avoid such liens, the debtor be permitted to redeem property from such a lien over a five year period by paying the creditor the value of such property during such period.

This proposal fails to take into account the fact that household goods are often subject to security interests held by different small loan companies. It is unclear whether after redeeming property from the holder of the first lien the debtor would then have to pay the second lienholder and

thereafter the third lienholder and so forth.

Sections 14 and 15 of the bill propose conforming amendments necessitated by the amendment to section 521 of the Code, dealing with the duties of the debtor.

Section 16 of the bill would amend section 1301 of the Code to make the automatic stay against collection from codebtors inapplicable to actions by a creditor to collect on a consumer debt from a codebtor who received the consideration for the claim or to the extent that the plan does not propose to pay the principal and interest on such claim in full.

Upon giving 10 days notice to the debtor and the codebtor of the creditor's intent to proceed to collect from the codebtor, the creditor would be permitted to pursue collection from the codebtor unless the debtor or codebtor files a written objection to such proposed action by the creditor.

The principal argument in favor of such an amendment is that it will save a creditor the expense of counsel fees and court costs necessary under present law which requires a complaint to obtain relief from the stay. The arguments against such an amendment are: (1) It would vest in the creditor the right to determine "the extent to which the plan proposes not to pay" a claim, as for example with respect to interest and collection fees. (2) Unimpeded extrajudicial pursuit of collection from a codebtor may result in indirect pressure on the debtor through the codebtor and cause the plan to abort. (3) A complaint for relief from stay filed in the bankruptcy court may include a request for judgment against the codebtor thereby eliminating the expense to the creditor of a follow-up suit in another court to collect from the codebtor. (4) At the hearing on such a complaint the debtor may choose to amend the plan to protect the codebtor or in the judgment against the codebtor the court may fix a payment schedule the codebtor can meet and thereby avoid the necessity of the codebtor filing for relief under chapter 7 or 13 of the Code.

Section 17 of the bill proposes to amend section 1321 of the Code to require the debtor to commence payments under the

plan concurrently with the filing of the plan.

This proposal appears to be rendered unnecessary by section 128 of S.863, which is already past the Senate and which amends section 1325(b) of the Code to permit the court to order the employer to commence payroll deductions as proposed in the plan upon the filing of the case.

Section 18 of the bill would amend section 1322(a) of the Code to make it mandatory that a plan provide for payments on nondischargeable claims of an amount that could have been reasonably collected over a period of five years if the case had not been filed.

This requires the court to presume that the creditor has successfully litigated a claim with respect to the nondischargeability of a debt, that the claim has been reduced to judgment, and that the claim could be collected by repeated garnishment of the debtor's wages over a period of five years. This presumption of nondischargeability would not be very meaningful in a state which has abolished wage garnishment. The collectability of such a claim would depend on the harshness or leniency of the legal environment of the debtor in each particular state. The proposal would be unfair and unworkable unless and until the question of the dischargeability of the debt is tried by the bankruptcy court, which would in turn delay indefinitely the confirmation of a plan.

Section 18 of the bill further proposes that section 1322(b) of the Code be amended to permit nondischargeable debts and codebtor claims to be separately classified for purposes of the plan in order that such claims may be given preferential treatment over other unsecured claims.

The arguments in favor of separate classification of nondischargeable debts are: (1) Resort to chapter 13 by debtors to avoid litigation and full payment of debts that are nondischargeable in a chapter 7 case detracts from the integrity of chapter 13. (2) A creditor holding a nondischargeable claim should be able to collect as much on the claim in a chapter 13 case as such creditor could collect on the claim following the

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conclusion of a chapter 7 case in which the debt was determined to be nondischargeable.

The arguments against separate classification of nondischargeable debts are: (1) The debtor and a creditor should not be permitted simply to agree that a claim is nondischargeable and therefore may be separately classified because such agreement may affect the amount other creditors will receive under a plan. Consequently, a trial may be necessary to determine whether a debt is dischargeable. Such a controversy necessarily will delay confirmation of a plan. (2) The debtor will pay a total sum for distribution to unsecured creditors under the plan and ordinarily will not be able to pay more simply because a particular debt is nondischargeable. If separate classification of a nondischargeable debt is permitted a creditor holding such a claim will receive a greater percentage of the pot than other unsecured creditors. In effect it is the creditors holding other unsecured claims and not the debtor who is paying more to the creditor holding the nondischargeable claim.

The argument in favor of separate classification of claims on which a codebtor is liable is: Debtors invariably make payments outside the plan to a codebtor to enable the codebtor to in turn make payments to the creditor. Such under-the-table payments jeopardize the ability of the debtor to carry out the plan. Therefore, as a practical matter, it would be better to enable the debtor to protect the codebtor by providing preferential treatment under the plan for claims on which a codebtor is liable.

The arguments against separate classification of claims on which a codebtor is liable are: (1) Prior law afforded no protection for codebtors. Debtors eschewed Chapter XIII and filed for relief in straight bankruptcy, after which, in order to protect a codebtor the debtor would reaffirm and continue paying the debt on which the codebtor was liable, while other unsecured debts were "wiped out" by the bankruptcy. The automatic stay against collection from codebtors was enacted in part to encourage payment of all unsecured claims. Permitting separate classification of claims on which a codebtor is liable will perpetuate the preferential treatment such claims enjoyed under

prior law, again to the detriment of other creditors holding unsecured claims. (2) Permitting separate classification of claims on which a codebtor is liable will encourage creditors to adopt a policy of insisting on a cosigner for all types of indebtedness. Daniel Webster described credit based on the signature of a codebtor as a "House that Jack Built." When the principal obligor becomes unable to pay the other obligors are toppled as well. This kind of credit granting ought not be encouraged because it may result in a chain of related bankruptcies. (3) A chapter 13 plan may not contain provisions that are inconsistent with the Code. Separate classification of claims on which a codebtor is liable appears to be inconsistent with section 502(e) of the Code. The policy enunciated in that section is that the only claim allowable on the date of bankruptcy is the claim of the principal creditor, which is no different from any other claim.

Section 18 of the bill proposes to further amend section 1322(b) of the Code to preclude modification of claims that are fully secured by a security interest in the debtor's residence, even though the claim may be likewise secured by a security interest in personal property. This would change the current provision of the Code which permits modification of mortgages secured by an interest in real estate that are likewise secured by an interest in personal property.

Section 18 of the Code likewise proposes to amend section 1322(c) of the Code to establish five years rather than three years as the basic period for a chapter 13 plan.

The three year period was adopted by Congress in 1938. At that time Congress refused to further extend the plan for fear that debtors would become wage slaves. The Bankruptcy Code adheres to the three year period and permits extension of the period only for cause shown, ordinarily at the instance of the debtor. Extending the payment period of a plan for five years will surely make chapter 13 more oppressive and less attractive to debtors.

Such an extension is rendered unnecessary by the flexible provision in section 1322(b)(5) of the Code, which permits

maintenance of payments on long term debt during the pendency of a plan and the payment of the balance due on such debt after completion of the plan.

Section 19 of the bill would amend section 1325(a) of the Code to insert a requirement that before confirming a plan the court must find that the plan proposes a bona fide effort consistent with the debtor's ability to repay his debts, after providing support for himself and his dependents.

The alternative "ability to pay" test proposed by the National Bankruptcy Conference merits more consideration than the proposed " bona fide effort" test proposed in this bill.

Section 19 of the bill would also amend section 1325(a) of the Code to require payment of interest at the contract rate on the secured portion of a consumer contract. This proposal assumes that the contract rate will ordinarily be the same as the current discount rate. The interest on consumer contracts ranges between ten per cent and 42 per cent, and the court should not be bound by such contracts in fixing an interest rate.

Section 19 of the bill also makes it mandatory that all chapter 13 plans extend for five years unless the plan provides for payment of at least 70 per cent of the allowed unsecured claims.

This proposal, when considered in connection with the proposal to restrict access to chapter 7 of the Code, as has been previously indicated, makes wage slaves of debtors and converts the bankruptcy courts into collection agencies for holders of consumer claims, all at the expense of debtors and taxpayers. The affluent consumer finance industry has never before enjoyed such privilege in any court, and we see no justification for an industry that has grown by leaps and bounds over the past 50 years, and which continues to grow at an unprecedented rate, to be permitted to demand such specialized treatment at the expense of taxpayers.

Section 20 of the bill would amend section 1328 of the Code to make debts that are nondischargeable in a chapter 7 case likewise nondischargeable in a chapter 13 case, to the extent

such claims "were not proposed to be paid as part of the plan."

This proposed amendment must be considered in connection with the amendment to section 1322(a) of the Code, contained in section 18 of the bill. The amendment proposed in that section makes it mandatory that the plan provide for payment on a non-dischargeable claim of as much as could have been collected during a five year period if the case had not been filed. The amendment proposed in section 20 makes the balance of the debt nondischargeable and therefore collectable after completion of the plan. Under these two amendments, nondischargeable claims receive better treatment in a chapter 13 case then in a chapter 7 case.

United States Bankruptcy Court
FOR THE
Eastern District of Kentucky

CHAMBERS OF
JOE LEE
JUDGE

November 16, 1981

The Honorable Robert Dole
United States Senate
2213 Dirksen Building
Washington, D.C. 20510

and

The Honorable Howell Heflin
United States Senate
3107 Dirksen Building
Washington, D.C. 20510

Dear Senators Dole and Heflin:

This letter supplements my testimony before the Subcommittee on Courts on October 29, 1981.

In my view the proposal to require all chapter 13 plans to be five-year plans is unnecessary and unwise.

The Bankruptcy Code presently accommodates the fact that certain long-term debts of a debtor cannot be paid within the basic three-year period of a chapter 13 plan.

Section 1322(b)(5) of the Code permits the plan to provide for "maintenance of payments" on long-term secured or unsecured debts on which the last payment is due after the date on which the final payment under the plan is due. Section 1328(a)(1) of the Code specifically excepts the balance due on any such indebtedness from the discharge the debtor receives upon completion of the plan.

The foregoing provisions were inserted in the Code based on knowledge that indebtedness on homes, which are financed over a 10 to 30 year period, on mobile homes, which are financed over a 5 to 10 year period, and motor vehicles, which are now financed over a 4 or 5 year period, cannot be paid off during the life of a plan.

Suppose a debtor is purchasing an automobile under a retail installment contract (security agreement) providing for payments of $200 per month over a period of five years or a total of $12,000. The plan may provide for the maintenance of payments on this debt by the debtor outside the plan while other debts are paid under the plan. In view of the fact that this flexible provision is already in the Code permitting the payments on a long-term debt to extend beyond the three-year period of the plan, the argument that plans should be extended to five years because motor vehicles are now financed over a four or five-year period is obviously without merit. That fact was taken into account when the Code was adopted.

Also a debtor may owe a large unsecured debt to a bank or credit union payable in installments over a period greater than three years. Lumping such debt with other unsecured debts to be paid under the plan may result in an amount too great to be paid by the debtor in a period of three years, thus requiring the debtor to propose a composition plan. As an alternative the debtor and the creditor can agree to a rewriting of the loan under a contract calling for maintenance of minimal monthly payments on such debt during the life of the plan and the continuation of such payments after completion of the plan. The other creditors are not harmed because this arrangement enables the debtor to pay them a greater amount under the plan.

It appears to me the credit unions and banks complaining about the present three-year plan simply have not educated themselves concerning the considerable flexibility permitted by sections 1322(b)(5) and 1328(a)(1) of the Code in structuring plans to accommodate payment of long-term secured and unsecured debts.

I appreciate the opportunity to express these additional views.

Yours truly,

Joe Lee

Joe Lee
U. S. Bankruptcy Judge

JL:glc

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United States Bankruptcy Court
FOR THE
Eastern District of Kentucky

CHAMBERS OF
JOE LEE
JUDGE

November 16, 1981

The Honorable Robert Dole
United States Senate
2213 Dirksen Building
Washington, D.C. 20510

and

The Honorable Howell Heflin
United States Senate
3107 Dirksen Building
Washington, D.C. 20510

Dear Senators Dole and Heflin:

I think it is important to focus attention on the magnitude, or more correctly, the lack of magnitude of the problem addressed by the so-called "Consumer Bankruptcy Improvements Act of 1981," in assessing the need for such legislation.

We learned at the hearings on October 29, 1981 that losses in the consumer credit industry approximate 6 billion annually and that consumer credit outstanding at the end of the 1980 calendar year was 385 billion. This means that losses are in the range of 1.5% of consumer credit outstanding.

$$385 \overline{)\ 6}\ .0155$$

The projected recovery of 1.6 billion would reduce the loss rate by 4/10 of 1% or to 1.1%.

$$385 \overline{)\ 4.4}\ .0114$$

Should the Government (the taxpayers) foot the bill for the substantial additional cost of administration inherent in this proposed change in the bankruptcy system in order to reduce the loss rate of the consumer finance industry by 4/10 of 1%?

Any benefit passed on to the users of credit may have to be taken from them in the form of additional taxes to support the increased cost of administering such a restrictive bankruptcy system.

Yours truly,

Joe Lee

Joe Lee
U. S. Bankruptcy Judge

JL:glc

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United States Bankruptcy Court
FOR THE
Eastern District of Kentucky

CHAMBERS OF
JOE LEE
JUDGE

November 16, 1981

The Honorable Robert Dole
United States Senate
2213 Dirksen Building
Washington, D.C. 20510

and

The Honorable Howell Heflin
United States Senate
3107 Dirksen Building
Washington, D.C. 20510

Dear Senators Dole and Heflin:

Supplementing my testimony on October 29, 1981 before the Subcommittee on Courts I submit additional statistical data indicating the consumer finance industry is wrong in its contention that the new Bankruptcy Code is responsible for the recent increase in nonbusiness bankruptcies.

These statistics show there have been periods in the past under old law when due to economic conditions the increase in consumer bankruptcies was just as dramatic, as at present, as for example during 1957-58, 1961, and 1975. See Table I.

Also note that the increase in business bankruptcies parallels the increase in consumer bankruptcies. See Table IV.

Table III indicates that although nonbusiness bankruptcies have increased somewhat in relation to population, such filings remain below prior levels in 1972, 1974, 1975 and 1976 in relation to consumer credit outstanding. For example, in 1975 there was one nonbusiness bankruptcy case for each one million dollars of consumer credit outstanding. In 1980 and 1981 there has been less than one case for each million dollars in consumer credit outstanding. These statistics suggest the increase in bankruptcies is due to economic conditions and the overabundance of consumer credit rather than to the new Bankruptcy Code. As my Table III shows the statistics concerning nonbusiness bankruptcies have been inflated by the Administrative Office of the United States Courts and the consumer finance industry by counting a joint husband/wife case as two cases.

Also please note from Table II the steady increase over the past 30 years of personal debt as a percentage of disposable personal income. All during this period debtors who became entwined in the tentacles of credit have had unrestricted access to bankruptcy and this has not deterred the growth of the consumer credit industry.

These statistics offer little support for change from the present voluntary bankruptcy system to a compulsory chapter 13 system.

Yours truly,

Joe Lee

Joe Lee
U. S. Bankruptcy Judge

JL:glc

Encls.

TABLE I

NONBUSINESS BANKRUPTCIES FILED

Fiscal Years 1946-1981 (July 1-June 30)

Year	I Number of Non-Business Cases (A)	II Percent Change Over the Previous Year
1946	8,566	-22.49
1947	10,234	+19.47
1948	13,537	+32.27
1949	19,144	+41.42
1950	25,040	+30.79
1951	27,806	+11.05
1952	28,331	+ 1.89
1953	33,315	+17.59
1954	44,248	+32.82
1955	50,219	+13.49
1956	52,608	+ 4.76
1957	63,617	+20.93
1958	80,265	+26.17
1959	88,943	+10.81
1960	97,750	+ 9.90
1961	131,402	+34.43
1962	132,125	+ 0.55
1963	139,190	+ 5.35
1964	155,209	+11.51
1965	163,413	+ 5.29
1966	175,924	+ 7.66
1967	191,729	+ 8.98
1968	181,266	- 5.46
1969	169,500	- 6.49

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TABLE I, page 2

NONBUSINESS BANKRUPTCIES FILED

Fiscal Years 1946-1981 (July 1-June 30)

Year	I Number of Non-Business Cases (A)	II Percent Change Over the Previous Year
1970	178,202	+ 5.13
1971	182,249	+ 2.27
1972	164,737	- 9.61
1973	155,707	- 5.48
1974	168,766	+ 8.39
1975	224,354	+32.94
1976	211,348	- 5.80
1977	182,210	-13.79
1978	172,423	- 5.37
1979	196,967	+14.23
1980	241,446	+22.58
1981	312,914(B)	+29.60

Source:

Column I - Administrative Office of the U.S. Courts, "Tables of Bankruptcy Statistics..." in packet of statistics entitled "Current Bankruptcy Statistics" sent to Chairman Rodino on July 7, 1981 by Berkeley Wright, Chief of the Bankruptcy Division, Administrative Office of the U.S. Courts.

(A) This is the sum of all nonbusiness bankruptcies filed under Chapters 7, 11 and 13 during July 1 to June 30 of each year.

(B) From Administrative Office of the U.S. Courts, Annual Report of the Director, 1981 Table F3B "U. S. Bankruptcy Courts Nonbusiness and Section 304 Bankruptcy Code Cases Commenced...during the twelve month period ending June 30, 1981." page A-128.

Table II

PERSONAL BANKRUPTCIES AND THE DEBT-INCOME RATIO, 1950-1980

Year	(I) Total Personal Debt Outstanding (A) (in billions)	(II) Personal Disposable Income (in billions)	(III) Personal Debt as a percentage of disposable personal income (B)
1950	70.841	206.6	34.29
1951	78.968	226.0	34.94
1952	91.051	237.7	38.30
1953	102.836	252.2	40.78
1954	113.892	257.1	44.30
1955	133.548	275.0	48.56
1956	148.268	292.9	50.62
1957	159.791	308.6	51.78
1958	170.402	319.0	53.42
1959	191.641	338.4	56.63
1960	207.004	352.0	58.81
1961	222.335	365.8	60.78
1962	243.217	386.8	62.88
1963	269.205	405.9	66.32
1964	295.991	440.6	67.18
1965	323.707	475.8	68.03
1966	342.649	513.7	66.70
1967	362.730	547.9	66.20
1968	391.749	593.4	66.02
1969	420.542	638.9	65.82
1970	441.213	695.3	63.46
1971	486.095	751.8	64.66
1972	549.839	810.3	67.86
1973	619.277	914.5	67.72
1974	662.827	998.3	66.40

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PERSONAL BANKRUPTCIES AND THE DEBT-INCOME RATIO, 1940-1980

Year	(I) Total Personal Debt Outstanding (A) (in billions)	(II) Personal Disposable Income (in billions)	(III) Personal Debt as a percentage of disposable personal income (B)
1975	713.940	1096.1	65.13
1976	805.416	1194.4	67.43
1977	945.002	1311.5	72.06
1978	1103.122	1462.9	75.41
1979	1262.290	1641.7	76.89
1980	1346.134	1821.7	73.89

1981 -- By June 30, 1981 personal debt outstanding reached 1384.487 billion dollars and is expected to climb much higher before the year end. Personal disposable income for 1981 based on statistics up to June 30 is 1966.7 billion dollars.

Sources:

Col I - Economic Report of the President, 1981 Tables B66 and B68 and Federal Reserve System, "Status of Periods" 1943-1981 for Installment Credit, noninstallment Credit and Mortgage Debt (Computer Printout in September, 1981)

Col II -Economic Report of the President, 1981 Table B21 and Congressional Research Service MiniBrief, Selected Economic Indicators (MB8122

(A) These figures are the sum of consumer credit outstanding and mortgage debt outstanding in billions of dollars. Consumer credit outstanding includes estimated non-installment credit and most short term- and intermediate-term-credit extended to individuals to finance or refinance purchase of consumer goods and services in two or more installments. Mortgage debt outstanding is calculated only on the basis of non-farm properties of one to four family houses. Mortgages for other multi-family accommodations as well as for commercial properties are not included.

(B) Computed on the basis of debt as of December 31 of the year and income received during that year.

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TABLE III

Fiscal Year	[1]Total Nonbusiness bankruptcy case filings — Number	[2]Total Consumer Credit Outstanding — Amount (millions)	Number of individual bankruptcies filed per 1 million dollars of consumer credit outstanding	[3]Population — Number (thousands)	Nonbusiness Bankruptcies — Number (per 100,000 population)
1972	164,737	177,639	.927	210,985	78
1973	155,707	203,077	.7667	212,932	73
1974	168,767	213,427	.7907	214,931	78
1975	224,354	223,140	1.005	217,095	103
1976	211,348	248,916	.849	219,179	96
1977	182,210	289,133	.6301	221,477	82
1978	172,423	337,359	.5102	223,880	77
1979	196,976	383,359	.5138	226,444	87
1980	241,397 ← includes 73,459 spouses	385,659	.6259	228,830	105
1981	312,914 ← includes 139,231 spouses	403,772*	.7749	230,822**	135

1 Bankruptcy filings are based on bankrupt estate totals for end of each fiscal year (June 30). Source: Administrative Office of U. S. Courts, Statistical Analysis and Reports Division.

2 The consumer credit outstanding includes installment and noninstallment debts and is calculated on the basis of a calendar year. Source: Federal Reserve Board.

3 The population data is calculated month to month and the above figures reflect end of calendar year statistics. Source: U. S. Bureau of the Census.

* Consumer credit outstanding as of September 30, 1981.

** Projected figure supplied by U. S. Bureau of the Census.

TABLE IV

BUSINESS BANKRUPTCIES FILED

Fiscal Years 1946-1981 (July 1-June 30)

Year	I Number of Business Cases (A)	II Percent Change Over the Previous Year
1946	1,630	-10.0%
1947	2,936	+80.1%
1948	4,973	+69.4%
1949	6,877	+38.3%
1950	8,352	+23.1%
1951	7,387	-12.8%
1952	6,542	-11.4%
1953	6,772	+ 3.5%
1954	8,888	+31.2%
1955	9,185	+ 3.3%
1956	9,478	+ 3.2%
1957	10,144	+ 7.0%
1958	11,403	+12.4%
1959	11,729	+ 2.9%
1960	12,284	+ 4.7%
1961	15,241	+24.1%
1962	15,655	+ 2.7%
1963	16,303	+ 4.1%
1964	16,510	+ 1.3%
1965	16,910	+ 2.4%
1966	16,430	- 2.8%
1967	16,600	+ 1.0%
1968	16,545	- 0.3%
1969	15,430	- 6.7%

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TABLE IV, page 2

BUSINESS BANKRUPTCIES FILED

Fiscal Years 1946-1981 (July 1-June 30)

Year	I Number of Business Cases (A)	II Percent Change Over the Previous Year
1970	16,197	+ 5.0%
1971	19,103	+17.9%
1972	18,132	- 5.1%
1973	17,490	- 3.5%
1974	20,747	+18.6%
1975	30,130	+45.2%
1976	35,201	+16.8%
1977	32,189	- 8.6%
1978	30,529	- 5.2%
1979	29,500	- 3.4%
1980	36,224	+22.8%
1981	47,414 (B)	+30.1%

Source:

Column I - Administrative Office of the U.S. Courts; "Tables of Bankruptcy Statistics..." in packet of statistics entitled "Current Bankruptcy Statistics" sent to Chairman Rodino on July 7, 1981 by Berkeley Wright, Chief of the Bankruptcy Division, Administrative Office of the U.S. Courts.

(A) This is the sum of all business gankruptcies filed under Chapters 7, 9, 11 and 13 during July 1 to June 30 of each year.

(B) From Administrative Office of the U.S. Courts, Annual Report of the Director, 1981 Table F3A "U.S. Bankruptcy Courts Business Bankruptcy Code Cases Commenced...during the twelve month period ending June 30, 1981." page A-126.

PREPARED STATEMENT OF TIMOTHY A. COLCORD

Dear Senator Dole and Members of the Subcommittee:

Visa U.S.A., Inc. ("Visa") is a non-stock membership corporation, incorporated under the laws of the state of Delaware, which administers the Visa Card Program within the United States. The membership of the corporation is comprised of approximately 12,000 commercial banks, savings banks, savings and loan associations, and credit unions which participate in the Visa Program. As of the end of 1980, the Visa "Blue, White & Gold" card was held by approximately 64,500,000 individuals and accepted at 1,800,000 merchant outlets and 42,000 member offices throughout the country. For the year 1980, total dollar volume of the Visa system in the United States exceeded $28 billion.

Through Visa membership in Visa International Service Association, Visa's members also participate in the worldwide Visa system. Internationally, the Visa system is comprised of more than 12,500 member institutions. Worldwide, the Visa card is held by more than 89,000,000 cardholders and accepted at more than 3,000,000 merchant locations. For the year 1980, the dollar volume of the worldwide system exceeded $43 billion.

Visa welcomes this opportunity following your October 29 hearing to comment on the need for changes in the federal bankruptcy laws. Like other members of the financial community providing services to consumers, Visa is alarmed by the continuing upward trend in bankruptcy filings and bankruptcy losses since the 1978 bankruptcy reforms took effect. These trends have established an urgent need for revisions which will assure the repayment of affordable debt and restore a balance between the interests of consumers who do not pay their debts and the interests of creditors and those consumers who do honor their obligations.

Experience Under the 1978 Act

The Committee has already received abundant testimony and data underscoring a number of trends that have developed since the Bankruptcy Reform Act of 1978 took effect:

1. There has been a dramatic increase in non-business bankruptcy filings.

2. Because many of the filings result in little or no recovery of debts, they have generated huge losses to unsecured creditors such as Visa card issuers.

3. A disturbingly large percentage of these filings have been made by persons with "affordable debt" -- persons with incomes and debt structures that would enable them to repay a substantial portion or all of their debts over time.

While we will not burden you by repeating statistics presented by others to document these general trends, Visa card issuers have reported similar experiences. In February 1981, 13 Visa card issuers who accounted for approximately 27% of the domestic gross dollar volume of Visa transactions in 1980 provided data comparing losses due to bankruptcy for 1980 and for the four-quarter period ending September 30, 1975. The latter period was selected for comparison to 1980 because of similar economic conditions and credit charge-off levels. Bankruptcy charge-offs accounted for 35.9% of the total net credit charge-offs in 1980, compared to 18.8% in the 1974-1975 period.

Visa members have more recently reported similar increases in bankruptcy charge-off ratios, as well as drastic increases in absolute dollar bankruptcy losses, over the past three years. For example, Manufacturers Hanover has experienced a 362% increase in its bankruptcy losses over the past three years, with the bankruptcy portion of its total losses rising from 14% to 34% during that period. South Carolina National Bank reports that its bankruptcy losses have increased from less than $46,000 in 1978 and $81,000 in 1979 to more than $267,000 in 1980 and $292,000 annualized in 1981. Similarly, personal bankruptcy losses in Bankers Trust Company's Visa card portfolio increased from $1.1 million in 1979 to $3.1 million in 1980, as stated in a letter of April 10, 1981 from Alfred Brittain, III to Senator Dole.

Visa members also confirm the general trend in the financial characteristics of customers declaring bankruptcy. For example, in 1981 through October, 48% of the South Carolina National Bank cardholders who filed for bankruptcy were not delinquent or were delinquent 30 days or less, and 43% had additional credit available. At United Virginia Bank, 80% of the cardholders whose bankruptcy notices were received in October 1980 were both current and without a prior delinquency history. As stated in the August 21, 1981 letter from Frederick S. Hammer to Senator Dole, 48% of Chase Manhattan Bank's card customers who file for bankruptcy have a five-year credit history, and most who file appear little different from other Chase customers.

Consequences

These bankruptcy filing trends are producing troublesome consequences. The changing profile of those who file has made it much more difficult to identify potential bankrupts under present credit evaluation systems. Creditors

have therefore been forced to reevaluate and tighten credit standards, thereby reducing or eliminating the credit available to many consumers who could afford larger extensions of credit. Further, increased bankruptcy losses must inevitably be passed on to other borrowers in the form of higher credit charges.

Finally, although some lenders are shifting their emphasis to secured credit, this approach is not realistically available to Visa members and other card issuers. As noted by Mr. Hammer, these unsecured creditors now find themselves in a triple bind: they cannot secure the credit; they cannot predict the bankruptcies; and they cannot recover anything in a majority of the bankruptcy cases.

Contributing Factors

Visa recognizes that increased bankruptcy filings and losses may be related to a variety of factors, including general economic conditions. However, the recent surge in personal bankruptcy filings has greatly outpaced unfavorable economic trends such as unemployment rate increases. Nor can bankruptcy trends be attributed to creditors encouraging consumers to become overloaded with debt. As shown in the Credit Research Center study, the portion of disposable personal income devoted to installment credit payments has been fairly constant since 1969 and was actually lower in 1980 than in the previous three years.

We must look to certain aspects of the 1978 Code itself, rather than the economy or the lenders, for the principal explanation. The overriding problem has been that Chapters 7 and 13, in combination, have permitted many to escape their debts without regard to their ability to repay them. Debtors with few or no non-exempt assets but sufficient income to repay their debts are able to discharge them by filing liquidation plans under Chapter 7. That Chapter looks only to the debtor's assets, not to his future income, as the source of repayment. This is directly contrary to the premise on which most unsecured consumer lenders, including card issuers, extend credit.

Debtors with more assets but limited incomes have been able to file under Chapter 13 and largely or entirely avoid repayment while keeping their property and making little or no sacrifice. Chapter 13 does apply an income-based approach, but has failed to assure reasonable repayment of affordable debt for a number of reasons.

First, and foremost, Chapter 13 lacks meaningful standards for determining what portion of the debtor's future income should be devoted to the repayment plan. The vague "good faith" standard has received widely varying applications, with debtors often being permitted to repay less than 25% of their debts.

Second, Chapter 13 enables debtors to discharge debts that they would otherwise be unable to discharge under Chapter 7 without losing their assets. This encourages such behavior as credit buying sprees shortly before filing.

Third, the generally applicable three-year limitation on Chapter 13 plans often prevents repayment of unsecured claims because most or all of the debtor's income typically must be devoted to secured claims and administrative expenses during the first two or three years. Recent studies suggest that a longer payback period could result in repayment of a substantial portion of these unsecured debts.

Fourth, delays between the submission of a Chapter 13 plan and the commencement of payments reduce the chances of ultimate compliance with the plan.

Recommended Changes

The key reform needed now is the establishment of a threshold test or standard for determining eligibility for federal bankruptcy protection, the type of plan to be used, and the amount of debt to be repaid. A debtor should be eligible to discharge his debts under Chapter 7 only if he cannot pay a reasonable portion of those debts out of that portion of anticipated future income which is not needed for the support of himself and his dependents. Others should be able to use Chapter 13 only if they make a bona fide effort thereunder which is consistent with their ability to repay debts after providing for such support.

To discourage credit buying sprees, Visa strongly supports the proposal to make debts incurred within 90 days before filing presumptively non-dischargeable.

Visa also supports proposals to amend Chapter 13 to extend the maximum repayment period to five years and to require payments to begin when the plan is filed rather than when it is confirmed.

Finally, Visa supports and urges the Subcommittee's careful consideration of other industry proposals dealing with federal exemptions, voidable preferences, exceptions to discharge, debtor income and expense statements, creditors' meetings, reaffirmation and co-debtor stays.

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Senator DOLE. Our final panel consists of Mr. Paul Tongue, senior vice president, Chase Manhattan Bank; Mr. Donald Beall, manager, NASA Federal Credit Union; Mr. Robert Evans, senior vice president and general counsel, National Consumer Finance Association; and Mr. Raymond Kennedy, vice president and general credit manager, Sears Roebuck.

I would say, as I have indicated to other witnesses, that your entire statements will be made a part of the record.

The one light on the clock means that there is a rollcall vote on the Senate floor, but I think we will have about 10 or 12 minutes; maybe we can conclude this panel in that time.

Senator HEFLIN. What is the vote on?

Senator DOLE. I think it is a Bradley amendment, which should be defeated. [Laughter.]

Senator HEFLIN. Just because that name Bradley is there, you ought not to put a Dole presumption to it. [Laughter.]

Senator DOLE. I am talking about the mayor; Bradley, I would vote for; he is a great guy on my committee.

Do you have a leader?

STATEMENT OF PAUL G. TONGUE, SENIOR VICE PRESIDENT, CHASE MANHATTAN BANK, NEW YORK, N.Y., REPRESENTING CREDIT UNION NATIONAL ASSOCIATION, INC., AND NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS, ACCOMPANIED BY A. THOMAS SMALL, VICE PRESIDENT AND COUNSEL, FIRST UNION NATIONAL BANK, RALEIGH, N.C.

Mr. TONGUE. Mr. Chairman, I am Paul G. Tongue, senior vice president, Chase Manhattan Bank, in New York; and I am accompanied by A. Thomas Small, vice president and counsel, First Union National Bank, Raleigh, N.C. We are testifying on behalf of the American Bankers Association and the Consumer Bankers Association, both of which are members of the National Coalition of Bankruptcy Reform.

We would ask that our written statement be made a part of the record.

We greatly appreciate this opportunity to appear before the subcommittee to discuss the important question of the treatment of debtors' current and future earnings under the recently revised Bankruptcy Code.

No single bankruptcy issue is of greater importance than requiring the consumer to repay those debts that are reasonable in relation to the consumer's ability to repay within the agreed time.

This general concept of affordable debt is critical, because of the way that consumer credit is extended and the need to provide an equitable distribution of the costs caused by bankruptcy.

We are appearing today in support of the legislative relief that takes into account Dr. Johnson's findings that $1.6 billion a year that defaulting consumers could pay is now being paid by other consumers who do pay their debts. Many banks have been able to quantify the impact of this massive increase in filings, reporting increases in losses due to bankruptcy ranging from 85 to 191 percent. In my own bank, bankruptcy losses on our VISA credit card program alone jumped from $1.76 million in 1979 to over $5 million in 1980—an increase of 186 percent.

The impact of the law simply cannot be ignored. It has a direct and adverse impact on credit costs for all consumers, since the consumers who do pay their debts must pay the cost created by consumers who do not, as well as the continued ability of banks to provide credit services.

Unsecured creditors are virtually defenseless. They cannot restrict credit in an incisive way, because they cannot identify those consumers who are likely to use bankruptcy to discharge affordable debt. They cannot easily secure their credit extensions, because many of these programs simply cannot be operated on a secured basis.

The inevitable result—a general reduction in credit for the use only of more expensive secured credit, when that alternative is possible—would not be desirable either to the credit industry or to consumers.

Mr. Chairman, we feel that we must refute forthrightly one recurring myth that creditors, by forcing more and more credit on consumers are to blame for the bankruptcy problem. The share of consumer income being devoted to pay consumer credit obligations was lower in 1980 than in any year since 1976 and was indeed lower in 1980 than it was in either 1971 or 1972.

This is also shown by consumer credit outstandings, which in 1980 increased by only 45 one-hundredths of 1 percent, despite double-digit inflation and population increases.

In short, despite unsupported assertions to the contrary, the credit industry cannot be fairly accused of enticing consumers to overextend themselves, thereby giving rise to increased bankruptcy problems.

In order to provide a more equitable approach both for persons facing financial adversity and those who are not but who must pay for the lawsuits caused by the bankruptcy system, the association would respectfully urge the subcommittee to act favorably upon a triad of critically needed amendments.

Senator DOLE. I do not want to shut you off, but we are already familiar with the amendments. We do not want to repeat ourselves. If we cannot complete this in a few minutes, we may have to come back at 2 o'clock. So if you could wrap yours up, we will move on.

Mr. TONGUE. Thank you, Mr. Chairman.

Senator DOLE. Thank you.

Mr. Beall?

STATEMENT OF DONALD V. BEALL, MANAGER, NASA FEDERAL CREDIT UNION, BELTSVILLE, MD., REPRESENTING CREDIT UNION NATIONAL ASSOCIATION, INC., AND NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. BEALL. Mr. Chairman, thank you very much.

My name is Donald Beall. I am the manager of NASA Federal Credit Union in Riverdale, Md., and a member of the Credit Union National Association task force on bankruptcy.

I am testifying today on behalf of both CUNA and the National Association of Federal Credit Unions. I would like to say that I am a working manager. I am one who makes loans, and I talk to my 19,000 members every opportunity I get.

My greatest concern—and I will sum it up very quickly—is that I see a dramatic change coming about in the way credit is going to be granted in the future if the law remains the same.

My small borrowing members may not get the opportunity to borrow, if we continue to have the bankruptcies that my credit union and the credit union movement in general is having. We may have to go—as the National Credit Union Administration is hinting—to collateral loans to protect the savings of our members on the other hand.

As a result, I think the subcommittee is faced with an issue which is simple. I believe it is an issue of whether the Congress wants to change the law to allow the credit grantors to be on an equal footing with the way they grant credit or whether the credit grantors will change the way they lend money. If they change the way they lend money, then we will, as credit grantors, lend money on the basis of collateral only, and that will take many, many of credit unions' most important people—the little men—out of the stream of credit.

Thank you very much.

Senator HEFLIN. You all do pretty good on those cosigners in the credit unions; that works pretty well.

Mr. BEALL. We do not have cosigners.

Senator HEFLIN. You do not?

Mr. BEALL. No, sir.

Senator HEFLIN. Down in my area they put the cosigners on.

Mr. BEALL. That is a good thought.

Senator HEFLIN. You had better pick it up from those Alabama credit unions. They know how to get that money collected.

Senator DOLE. They do a pretty good job, I am told.

Mr. Evans?

STATEMENT OF ROBERT B. EVANS, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL CONSUMER FINANCE ASSOCIATION, WASHINGTON, D.C.

Mr. EVANS. Thank you, Mr. Chairman.

I guess our basic quarrel is that the courts do not want to follow what the Congress asked them to do in 1978. The 1977 House report said, "The premises of the bill with respect to consumer bankruptcy are that the use of the bankruptcy law should be a last resort; that if it is used debtors should attempt repayment under chapter 13, Adjustment of Debts of an Individual with Regular Income;" and so forth. Unfortunately, Mr. Chairman, the courts have seen fit to employ that premise in very few cases.

I include in my statement [1]—which I will just review briefly for you—a comparison which shows very vividly how chapter 13 is used around the country compared to chapter 7, depending on what State you are in. This is according to most recent reports from the Administrative Office.

In Maryland, chapter 13 has accounted for 4,907 cases, as opposed to chapter 7 accounting for 292 cases in the last year—June to June. That is, only 5.6 percent of the cases are chapter 13's.

[1] See page 237.

If you go to the middle district of North Carolina, you see that 77 percent of the cases were chapter 13. In North Carolina, the entire State has 67 percent—67 percent in North Carolina, and 5 percent in Maryland.

If you go to just one district, I will show you how two different judges look at it. Judge Kelley, who was written up in the Washington papers here recently—and we call him Judge Roy Bean, because he runs his court just like that—had 1,018 chapter 7's and 1,436 chapter 13's—almost 60 percent. If you look at Judge Bare, who sits in the same district, you will see that he had less than 10 percent chapter 13's—almost 60 percent for Judge Kelley and 10 percent for Judge Bare.

What accounts for that? Are the people poor in Judge Bare's district? Are they poorer in Maryland than in North Carolina? Of course not. Anyone could look at these statistics and estimate that something is wrong here. You do not need any fancy studies—$300,000 worth or 280 cases, or whatever—to tell you that the way this is effectuated is based on what the judges perceive they want to happen in their courts.

Why do not debtors take chapter 13 more often? The reason is that they have no economic incentive to do so. As Dr. Johnson's study will show, only 5 percent of them were technically solvent. So if they have nothing to lose, why not go to chapter 7?

Senator DOLE. I have got to make a point here. I have to go vote. If you want to wait until I get back—and I do not want to shut anyone off—I do not want to hold the first two witnesses.

We will be submitting some questions in writing, and we will make the same request of others. Depending on what happens with this legislative initiative, we may be asking for some input in addition to what may appear in your statements.

I will run over and vote and come back. I do not want to cut Mr. Kennedy off here. With a name like that, he ought to have some time. [Laughter.]

[A brief recess was taken.]

Senator DOLE. Mr. Evans, do you want to conclude? Then we will hear from Mr. Kennedy.

Mr. EVANS. Thank you, Mr. Chairman.

I will try to cover the one point that seems to have raised the most controversy here today. It is the last point made by Professor Countryman, and others have brought it up. I will categorize it this way:

No. 1, the courts can either not handle cases, or if they can handle them they cannot decide them. That is the thrust of what they are saying. This is going to burden the courts: "We cannot handle this many. But even if we could handle them, how in the world would we ever decide what a debtor is going to be able to pay over the next 5 years?"

Well, they are not being entirely honest with you on that point, because the National Bankruptcy Conference is proposing that that very same thing be incorporated in chapter 13—an ability to pay standard. Granted, the consumer himself will propose it, but if the creditor objects, who is going to have to decide it? The court will.

All we are saying is let us put that in 13, but just give the court the ability in chapter 7 to make the determination initially. And

here is what the question would be he would ask himself—Judge Lee would ask—"Taking this petition and all the disclosures on it of income and expense into account, could this person be reasonably expected to fashion a plan in chapter 13? If so, I will grant the petition and dismiss this case. If not, I will allow the discharge." It is a very simple, reasonable thing.

Tom Small practices in North Carolina in the eastern district. They have had an ability to pay standard down there for years and virtually no litigation. The debtors in that district se chapter 13 almost exclusively, and none of them—contrary to Professor Countryman's concerns—manage to quit work to get out of paying their debts. It just does not work that way. It is a very, very successful operation.

In summing up, I would like to say what we are trying to do is this: Judge Rufus Reynolds, Judge Eaton in Mississippi, and Judge Kelly in Chattanooga, Beryl Maguire in New York run very fine consumer bankruptcies operations which are consistent with the principles we are trying to get established here. If we can find some way to get that into legislation, we know from experience no one is going to be hurt.

Thank you.

Senator DOLE. Thank you.

Mr. Kennedy?

STATEMENT OF RAYMOND A. KENNEDY, VICE PRESIDENT AND GENERAL CREDIT MANAGER, SEARS, ROEBUCK & CO., CHICAGO, ILL., ON BEHALF OF AMERICAN RETAIL FEDERATION AND NATIONAL RETAIL MERCHANTS ASSOCIATION

Mr. KENNEDY. Thank you, Mr. Chairman.

I am Raymond Kennedy, vice president and general credit manager of Sears. I am speaking today on behalf of the American Retail Federation and the National Retail Merchants Association who represent more than 1 million retail establishments.

Being the last speaker may turn out to be an enviable position after all, because I understand I can use as much time as I choose. [Laughter.]

Senator DOLE. There may not be anyone here to preside. [Laughter.]

Mr. KENNEDY. I do appreciate very much your coming back, and I would just like to take a couple of minutes to highlight a couple of the most significant points from the prepared testimony that I have submitted.

We are encountering a different class of debtors from what you would traditionally expect as petitioners for bankruptcy. These are persons who are current on their required monthly payments and who have little or no previous history of delinquency. Some may even have available credit at the time that the bankruptcy petition is filed.

It is a fairly substantial class. Extensive surveys at Montgomery Ward's and at Sear's show that 13 percent of the bankruptcy cases that we encountered were in this category. At Federated Stores, the survey was taken in a little different way, and they found 157 percent increase from 1979 to 1980 for debtors in this category.

These, together with another large segment having only limited levels of overdue payments, we would hold, represent debts which could be paid in whole or in part through a commitment of the debtor's future income. These are persons we do not regard as having a severe financial situation—no different than countless other people who have experienced some financial reversals but are meeting their responsibilities without serious hardship.

If one of the considerations is the burden of cases on the courts, it would appear that many of these people under the new proposed provisions just would not appear in the bankruptcy courts.

The other key point is with regard to consideration of future income in the evaluation of a debtor's need for a discharge of debts in bankruptcy. The nature of credit has changed dramatically in the last few years. At Sears, for example, only 5 percent of credit now extended is on closed end or secured credit, the vast majority being open end, revolving credit—unsecured credit.

In 1970, 40 percent of the credit extended by Sears was closed end and secured. In the industry in total, outstanding debt on revolving credit has increased from $5.1 billion in 1970 to $55.3 billion in 1979, a tenfold increase.

The other area of change is in the regular charge account credit. In department stores from 1975 to 1979, 30-day accounts, or those accounts required to be paid in full each month, decreased from $1.2 billion to $1.1 billion, while revolving accounts rose from $10.6 billion to $18.4 billion.

The 30-day credit of course is more like the closed end. It was offered to the customer on the basis of assets—generally cash in the bank. So the basis for extending credit then has changed a great deal, from the assets-for-security basis to an ability to pay from income. The Bankruptcy Code as presently constituted relates to the old credit basis, and determinations are based on debt versus assets consideration.

The question, I think, was raised that increased bankruptcy losses for credit grantors stemmed from an inadequate basis for extending credit—easy credit. I think "improvident loans" was the term used here. I would say that this is not so. Today's credit extensions are certainly simplified. There is less cost for the credit grantor in today's approach to credit with the credit card, less red-tape for the consumer, but not at lower standards for the establishing of credit.

Retailers and other credit grantors have successfully made this transition from the old basis of asset-security-based extensions to the present future income-based offerings of credit.

Retailers and almost all credit grantors have become very skilled with experience and the technological advances—point scoring, communications networks for controlling lines of credit—in assessing credit worth. This skill is really required when it is considered in the light of the cost of credit to the retailer today versus the revenues that the accounts generate. There is just no room for overly liberal extensions of credit.

We have generally maintained our account delinquencies at the same levels over these many years, as we do today. The principal alteration in circumstances today is the sizable increase in bankruptcy losses experienced in 1980 and 1981.

So the Senate staff has developed an equitable solution that, while addressing the situation where the debtor could afford to repay a reasonable portion of the debt from future income, preserves the bankruptcy alternative for those in financial distress and needing total relief. We, the retail industry, strongly support that solution.

Thank you very much.

Senator DOLE. Again, I think we have had some good testimony.

As I said before we left for the vote, we will be working on a staff level and working with those of us on the subcommittee to try to see if there is any middle ground or if there is any way it is going to pass as recommended; I do not know.

We appreciate the testimony we have had today. I will be submitting some written questions to members of this panel in the event that we find there are some unanswered questions or if certain statements made by previous witnesses—and that will apply to all the witnesses who were here today—need some rebuttal or some clarification.

I have no questions.

Senator Heflin?

Senator HEFLIN. I would like to extend the invitation to this group that we did to all the other groups, pro and con on this. If they would draft some proposed legislation which we could study, and point out areas of concern or anticipated problems that could arise with this, it would be helpful in the event that we move toward it.

Senator DOLE. Obviously, there are some who already have provisions drafted. The question might be that in the event modifications need to be made, we certainly would appreciate the input of all the witnesses who were here today.

There are some who just do not agree that we ought to do anything. Others agree, as this panel has, and apparently as Mr. Evans indicated, that it does work in certain areas of the country without a hardship on the debtor. We would be interested to have more information on that.

I think you said specifically in North Carolina?

Mr. EVANS. Mr. Chairman, maybe you would like to correspond with Judge Rufus Reynolds and some of the other judges who seem to do this by fiat if not by law. They seem to run very socially acceptable operations. We would be glad to provide more data to you.

Senator DOLE. We do not want to increase the workload of judges, but not too many have dropped from exhaustion that I am aware of.

Mr. SMALL. Mr. Chairman, I practice in North Carolina, and I will be happy to provide the subcommittee with information about the North Carolina experience.

Senator HEFLIN. Is there any area of approach, apart from the safety net basis—with certain things like indexes on, say, a family of four—that it would not be applicable to? Do you have a volume of bankruptcies?

In other words, if somebody is on food stamps, the amount of money is negligible. As I gather, what we are driving at here is somebody in the neighborhood who is making $15,000 or above,

who can pay, and they get out of it and do not pay. But there is an element of people who are really poorly situated. In the long run, it probably would not justify all the effort. Is there a floor that you would like us to approach? What is your feeling on something like that?

Mr. EVANS. Senator Heflin, let me respond to that in this way. I think the study is going to be very helpful to you on this point. I asked Dr. Johnson about that. He has indicated that very few of those in the study for whom they ascribe the ability to pay were below this basic living standard that the Government sets the poverty level at, whatever it is. Almost all of the people who had some ability to pay were far above that level. Obviously, if no one below that level is in the category that can be expected to pay, that may be the place to establish the cutoff.

I am not suggesting that we need it, because I think the courts themselves—given the data on the consumer's own condition and regardless of anything else, whether you want to set a presumption of ability to pay or whatever—will take a look at it and say, "This debtor couldn't pay any reasonable amount in a chapter 13 plan in, and I am just going to grant his discharge."

Further, I think one thing has been overlooked today and should be considered along with this. That is the economic incentive on the part of the creditor to come in and contest such a petition. It simply will not pay to contest marginal cases.

For a creditor to hire an attorney and pay him $600 to make an appearance to argue such a proposition, merely to have the debtor's petition denied so that he has to go into 13 and fashion a 10-percent plan, just will not make economic sense.

Senator HEFLIN [acting chairman]. Thank you. We appreciate your testimony.

[The prepared statements of Messrs. Tongue, Beall, Evans, and Kennedy follow:]

PREPARED STATEMENT OF PAUL G. TONGUE

Mr. Chairman:

I am Paul G. Tongue, Senior Vice President of the Chase Manhattan Bank, N.A., and an active participant in a number of activities of both the American Bankers Association and The Consumer Bankers Association. The American Bankers Association's membership consists of more than 90% of the nation's full service banks including more than 12,000 community banks with deposits of $100 million or less. The Consumer Bankers Association has a membership of over 400 commercial banks of all sizes that are actively engaged in extending consumer credit, holding over 65% of all consumer credit outstandings held by commercial banks, more than $88 billion.

We greatly appreciate this opportunity to appear before the Subcommittee to discuss the important question of the treatment of the debtor's current and future earnings under the recently revised Bankruptcy Code. As both Associations testified before this Subcommittee earlier this year, the bankruptcy problem is one of the most critical issues now facing the retail banking industry. The direct impact of the new law, in conjunction with other factors, has produced substantial losses and the real potential for even greater exposure to future losses.

No single issue in the bankruptcy area is of greater concern and importance than the question of requiring the consumer to repay those debts -- or that portion of debt -- that are reasonable in relation to the consumer's ability to repay within the agreed time. This general concept, commonly referred to as "affordable debt", is critical because of the

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way in which consumer credit is extended in this country today and due to the need to provide a sound and equitable policy with respect to the shouldering of the costs created when consumers file under the Bankruptcy Code.

We are appearing here this morning in support of legislative relief that takes into account the findings presented earlier by Dr. Robert Johnson of Purdue University's Credit Research Center. We would like to discuss very briefly the bankruptcy context as it relates to the banking community, the demonstrated need for change in the way in which existing and potential earning power is treated under the bankruptcy code, and, finally, express our support for three amendments that we believe to be essential to a reasonable allocation of losses being generated by the bankruptcy system.

The Current Bankruptcy Context

Since the effective date of the 1978 Reform Act, bankruptcy filings have increased at an alarming rate. During the past calendar year bankruptcy filings were up 75%. From June 1980 to June 1981 filings were up 112%, suggesting an acceleration of filings. Perhaps of greatest concern, the figures on filings demonstrate that the increases cannot be directly correlated to current economic conditions as represented by the unemployment rate.

Several major banks have been able to quantify the impact of this massive increase in filing. Comparing 1979 with 1980, the first full year under the new law, one large Midwestern bank saw an increase in their dollar losses due to bankruptcy of 84.6%. In the case of that bank, in 1979 only 13.7% of its charge-offs were attributable to bankruptcy, while in 1980 that figure jumped to 25.8%. Other

banks have seen bankruptcy losses during that period in connection with their bank card programs alone increase from $1.3 million to $3.3 million, 154% (a West Coast bank), from $1.1 million to $3.2 million, 191% (a New York bank) and from $1.45 million to $3 million, 110% (another West Coast Bank).

In the case of my own bank, losses on our VISA card program caused by bankruptcy jumped from $1.76 million in 1979 to over $5 million in 1980, an increase of 186%.

The impact of the law simply cannot be ignored. It has had a direct and adverse impact on bank profitability, which inevitably will affect credit costs for all consumers -- since consumers who pay their debts must pay the costs created by consumers who do not -- and the continued ability of banks to provide credit services. One study indicated that comparing 1979 with 1980, bank losses in the consumer lending area had gone up 40%. The study concluded that bankruptcy losses were a major contributing factor to that increase.*

In general, the losses do not stem from a few isolated examples of abuse, but rather from an increasing trend to use the bankruptcy mechanism to deal with what is essentially affordable consumer debt. In many cases, consumers who have sufficient income to meet their debts are finding that the burden of paying their debts can be more expediently cured by filing bankruptcy than by altering the lifestyle to which they have become accustomed.

Mr. Chairman, it is imperative that we emphasize that we are not here today to discuss a mere handful of isolated

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* The study was performed by Keefe, Bruyette & Woods, Inc., a specialist in bank securities.

abuses under the new Act. While so-called "horror stories" may be helpful in providing clear evidence that the system permits abuses to occur, it is not that handful of cases which gives rise to our concerns. Rather, it is what appears to be an increasingly large percentage of filings by persons who have modest, but reasonable, incomes and who have debt structures that are not at all out-of-line with their incomes. It is this significant portion of new filings that is the source of most of our current losses and presents our largest exposure to future losses.

Immediate Bankruptcy Relief: Both Necessary And Appropriate

Before advancing specific suggestions for more equitable treatment of affordable debt, Mr. Chairman, we would like to address several arguments that have been advanced in suggesting that bankruptcy reform at this time is not appropriate. These arguments include the contentions that there has been too little time to analyze the effects of the new law, and that the credit industry, by overburdening the consumer with debt, is to blame for any surge in bankruptcy filing. As we will discuss, we earnestly believe that neither of these suggestions is valid and that relief from the current situation cannot reasonably be withheld on either of these grounds.

Impact Of The Act -- Currently And In The Future

There is an urgent need for immediate bankruptcy relief. That need, reflected by dramatic increases in both bankruptcy filings and in losses caused by bankruptcies, we believe has been fully documented. Moreover, the nature of the problem we are facing makes it certain that these problems will continue and even accelerate due to the inability

of creditors to identify and therefore avoid potential bankrupts.

The current bankruptcy rules make potential bankrupts virtually "invisible" to creditors on the basis of the best credit evaluation systems that the credit industry has been able to devise. In a significant number of cases, literally the day before a consumer files a petition in bankruptcy, the consumer would be considered by the best credit scoring systems and judgmental evaluation approaches as being creditworthy and, indeed, entitled to additional credit.

To demonstrate the magnitude of this problem, one large West Coast bank studied a random sample of 320 bankruptcy cases. Based on a review of the bank's files, between 18% and 30% of those who filed would have been entitled to obtain additional credit the day before they filed. Thus, about 1 in 4 of those who filed, the day before they did so appeared to that bank's credit scoring system as good credit risks, with high credit ratings; consumers to whom that bank or any other creditor would have given more credit. How can the banking industry distinguish those credit applicants from the others who seek and want credit and will be able to repay it?

Because the new Act removed virtually all disincentives to filing, the cases we are experiencing now are not of the same type that we used to see under the old Bankruptcy Act. Those cases generally involved persons who were suffering the effects of unemployment or economic difficulties or health problems. Today, however, they are consumers who, by all criteria, were creditworthy when credit was extended and continue to be creditworthy despite the fact that they have a federal mechanism available for shedding their debts. As

described earlier by Dr. Johnson, the recent study by the Credit Research Center revealed that in more than 78% of the households that filed for bankruptcy -- almost four in five -- there was a member who held a full-time job. This illustrates the changing nature of the cases being filed in the bankruptcy courts.

The long-term implications of this problem are clear. If the credit community were able to identify those who are in difficulty or who may be headed for difficulty, it would be a simple enough task to refuse to grant credit to them. If, however, as is now the case, those who have access to these proceedings are consumers whom we would identify as being legitimate, good credit risks immediately before filing, restrictions simply are not available. This means that the bankruptcy system has created the potential for persons who have affordable debt reflected by reasonable debt structures to take advantage of that system notwithstanding their economic ability to meet their obligations.

It is not responsive to suggest that such an inability is "the credit industry's problem;" it should develop better techniques. It is, of course, not "our" problem since, as a systematic matter, creditors who cannot identify consumers who are likely to use the bankruptcy process are unable to avoid extending credit to them. Those who have used that bankruptcy process -- and, thus, those who might use it -- do not have a profile, the common characteristics that might provide an alert to creditors in the course of their credit evaluation processes. Absent such information, potential bankrupts will remain invisible to potential creditors since literally no system can be devised to identify them.

The inevitable result, can only be one of two outcomes,

neither of which is good. The first is that creditors will be forced to reduce credit availability generally -- in most cases starting by denying credit to the young and to lower income consumers. The second possible alternative is to regress from the current, highly efficient system which makes unsecured credit widely available, to the more cumbersome, expensive system under which all credit is secured by whatever collateral the consumer can provide. Neither result would be desirable either to the credit industry or to the consumers it serves.

In short, the new Act has caused substantial problems to date and since the credit system has no way of identifying potential bankrupts and thus excluding them from the credit market, the crisis is likely to intensify rather than moderate. Only by immediate remedial legislation -- admittedly not a cure-all but still a critical ingredient -- will it be possible to achieve a more reasonable balance between the rights of those who do pay their obligations and those who do not.

Immediate Legislative Action Is Appropriate

In light of the current crisis and the potential for even greater problems caused by the new Act's making potential bankrupts "invisible", we believe that Congressional action is needed now. We recognize that the new Act has not been the subject of a long period of judicial or administrative scrutiny. It seems certain that some of the current mechanical problems will be resolved as the judicial process shapes and responds to the new provisions. We strongly believe, however, that there are problem areas that arise either directly from the statute, or from judicial interpretations of the statute that seem likely to shape the law in this area absent further Congressional action.

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We are limiting our comments this morning to the question of the appropriate treatment of debt that consumers can afford to repay in whole or in part. This is a matter that can only be changed by Congressional action. Limiting our comments to those areas, even though the statute has been in effect for only two years, we believe that the need for certain changes in this area has clearly been demonstrated and that the absence of an extensive period of actual experience should not stand as a barrier to remedial action. Indeed, as the losses described above demonstrate, immediate action is not only appropriate, it is essential.

In discussing both the need for, and the nature of, necessary changes, we understand fully that the 1978 amendments to the Bankruptcy Code under discussion today were the result of extensive efforts by many members of the Senate Judiciary Committee and others to attempt to arrive at reasoned compromises on difficult issues.

It says nothing negative about the exhaustive efforts of the past that all of us were unable to anticipate with precision how this new law would work in the real world. As the members of the Subcommittee are fully aware, the comprehensive Bankruptcy Reform Act of 1978 was the result of exhaustive efforts first by members of an independent Commission and then by members of both the Senate and the House. In fashioning the first comprehensive revision of the 1898 statute in forty years, it seems virtually inevitable that certain changes would require reevaluation once they had been tested in the real world. For example, it seems difficult to have anticipated fully the extent to which consumers would file low or no dividend plans under Chapter 13.

A rapid Congressional response to the unintended results of legislation is by no means unprecedented. In 1975, the Real Estate Settlement Procedures Act -- which established a series of timing and disclosure requirements in connection with residential real estate transactions -- became effective. Less than one year later, Congress, learning of the problems involved with it and the adverse unintended consequences it produced, substantially and significantly revised the original act. The amendments totally overhauling the statute were devised, adopted by both the House and Senate and became effective almost exactly one year after the effective date of the initial statute. The need for revaluation -- even on a relatively expeditious basis -- is neither inappropriate or unprecedented.

That seems particularly to be the case in view of the issues presented in the complex area of bankruptcy. The policy decisions reflected in the new Act involve deliberate and difficult line drawing among the interests of the various participants in credit transactions. It is not at all surprising that even the most carefully drawn response should be the subject of refinement once it has been tested in the practical legal and credit environments.

In drawing these lines, it is essential to point out that the traditional reference to favoring or harming "the creditor" is simply a shorthand reference to those who are actually paying the cost. Banks, as with literally all other creditors, virtually never assume the losses occasioned by bankruptcies. Rather, since banks operate as financial intermediaries, the costs generated by bankruptcies are merely passed on to other consumers in the form of higher prices for credit.

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Thus, in a very real sense, the close policy judgments involved in the bankruptcy area must be viewed as weighing the interests of consumers who meet their credit obligations against the interests of those who cannot or do not meet their obligations. If for no other reason than to protect the vast majority of bill-paying consumers, the Act should not provide easy or routine or totally painless access to this federal governmental intervention which shifts the debts of the "non-payers" to the "payers." We are appearing before this Subcommittee in the sincere belief that the thoughtfully drawn lines contained in the current law, particularly as they relate to a total discharge of affordable debt, simply have not proved to be reasonable when applied in the real world.

Immediate Relief Should Not Be Delayed By Incorrect Assertions That Creditors Have "Overloaded" Consumers With Debt

Mr. Chairman, in considering the bankruptcy question, we feel that we must address forthrightly one recurring myth that some have suggested should somehow preclude the credit industry from seeking relief in this area. The myth is that creditors themselves are to blame for the bankruptcy problems since they have encouraged consumers to overload themselves by making more and more credit available, particularly in the past few years. It is this recent surge in credit, the argument goes, that has caused the increased bankruptcy filings in 1979 and 1980. The facts, however, clearly refute this suggestion.

The share of consumer income being devoted to pay consumer credit obligations was lower in 1980 than in any year since 1976. Moreover, the percentage of disposable personal income used for that purpose was actually lower in

1980 than it was in either 1971 or 1972. Viewed over the past twelve years -- that is, comparing 1969 and 1980 -- there is a difference of only 1.1% in the portion of disposable income allocated to these debts. In fact, since peaking during the end of the 1970's, the amount of disposable income being applied to consumer debt has decreased. These data clearly reveal that consumers are devoting less not more to payments of consumer debt.

In addition to an income statement analysis that demonstrates that consumers have not become overextended, a similar result is produced using a balance sheet approach. For example, at the end of 1979, consumers had increased their financial assets by $84 billion more than they increased their liabilities.* Quite clearly, on the basis of traditional balance sheet analysis, consumers are in a significantly better position than ever before.

The absence of overburdened consumers is also shown by looking at the total amount of consumer credit outstandings during the period in question. During 1979, consumer debt outstandings increased by 13%, a rate that simply matched the rate of inflation for that year. In 1980, however, there was an increase in consumer credit outstandings of only .45 of 1%, despite double-digit inflation and population increases that produced a larger number of potential credit consumers. Even these modest increases in the past few years are overstated due to changes in the composition of consumer credit. With an increased use of revolving credit has come a generation of "credit users" who in fact use revolving credit for convenience, paying off their

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* See ABA Bulletin on Consumer Economics, First Quarter, 1980, analysis by Dr. Robert H. Johnson, Credit Research Center, Purdue University.

balances each month. Historically, these would be cash and not credit transactions and so would not have been reflected in the credit aggregates that are reported.

In short, Mr. Chairman, despite unsupported assertions to the contrary, the credit industry cannot be fairly accused of enticing consumers to overextend themselves, thereby giving rise to increased bankruptcy filings. Consumers are not too deeply in debt and consumer debt is well within reasonable limits permitting consumers to repay their obligations in accordance with their agreement.

Affordable Debt: A Credit Granting Standard And Its Bankruptcy Implications

As noted above, affordable debt refers to debt that is reasonable in relation to the consumer's ability to make payments over the term of the credit transaction. The affordable debt concept is of particular importance to consumer lenders because it forms the basis on which credit decisions are reached. Several decades ago, virtually all credit evaluation was based in large part on the assets owned by an individual and the creditor's ability to look to those assets if necessary in order to realize on its loan. During that era, consumers seeking credit would provide detailed financial statements, their assets and liabilities were carefully weighed, and any credit extended was secured, generally requiring the preparation of additional documents and the payment of various filing or recording fees.

As our country became more mobile, as lifestyles changed and consumers sought more credit that they could adapt to their needs, this somewhat cumbersome and expensive system of traditional secured installment credit gave way to less expensive, more flexible unsecured credit. This shift in

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consumer demand and expectation gave rise to the contemporary credit market in which the most dynamic force is unsecured credit.

Unlike traditional installment lending, which was based on assets, this new approach to providing credit services is based on the consumer borrower's current and future income. This almost complete change in the credit system, also caused changes in the evaluation process being used in connection with consumer credit. In the contemporary system, it is the consumer's income and debt structure that forms the principal criterion upon which credit decisions are made.

Because of that change, a bankruptcy process that looks only to a consumer's assets and disregards the consumer's ability to pay at least some of his or her debts out of future earnings, simply fails to recognize the dramatic changes that have taken place in the credit market. This produces a significant discrepancy between the underlying principles used by the industry in extending credit and the creditor's ability to recover in a bankruptcy situation.

Contrary to some suggestions, the validity of this approach to credit granting -- which provides low cost, flexible credit to consumers -- is not placed into question by the significant increase in bankruptcy filings experienced since the 1978 amendments to the Bankruptcy Code took effect. Indeed, as demonstrated by the figures provided by Dr. Johnson, even a significant portion of those who file bankruptcy have a substantial ability to repay their debts. The problem is not that the credit industry has been using incorrect measures of creditworthiness in meeting consumer demand. Rather, the problem has arisen due to the fact that consumers who have sought relief have been given a full discharge and not

merely a discharge only to the extent that they cannot afford to pay their debts.

The answer to this problem requires legislative relief.

Bankruptcy Relief: A Necessary Triad Of Amendments To Chapters 7 And 13

In order to provide a more equitable approach both for persons facing financial adversity and those who are not -- but who must pay for the losses caused by the bankruptcy system -- the Associations would respectfully urge the Subcommittee to act favorably upon three critically needed amendments. The three interrelated amendments, a triad, if you will excuse a term being used a great deal these days in a somewhat different context, are essential to a reasonable solution of the current situation.

These amendments would permit consumers who do not have the ability to repay any of their debts to have a complete discharge of all of their debts. Those consumers who do have the ability to pay at least some of their debts, however, would be required to make payments to the extent of that ability. This result assures relief to the consumer debtor who is in economic trouble, while making certain that debts that are affordable are paid by the consumer who incurred them and not by other consumers who pay their debts.

First: Limit Access To Chapter 7 To Those Who Really Need It

The first amendment would limit access to Chapter 7 legislation bankruptcy proceedings to those who truly need this extreme form of relief. Consumers who because of illness, unemployment or other personal or financial problems simply cannot pay their debts and have no real prospect of being able to do more than meet their basic living expenses,

would continue to file under Chapter 7. According to Dr. Johnson's data, this group includes over 50% of those now filing liquidation bankruptcies. These consumers would be unaffected by the change we are proposing.

Other debtors who are now filing under Chapter 7 and discharging debts that they could pay -- at least in part -- would be affected by the proposal. These debtors, who have the ability to repay non-mortgage debt, would be prevented from using Chapter 7. As Dr. Johnson has testified, this would mean under the proposed amendment that about $1.6 billion of debt a year, that consumers who are filing in bankruptcy could repay would not be discharged.

It bears repeating, that as we described above and as Dr. Johnson has testified, this means that $1.6 billion a year less -- relected in losses caused by defaulting debtors -- would be transferred to consumers who pay their debts. Both sound public policy and fundamental fairness dictate that this tremendous transfer of costs from non-payers -- who can pay -- to the payers, should be stopped.

In determining eligibility for Chapter 7, the court should decide whether the consumer has income, and is likely to continue to have income, from which he or she could pay a reasonable portion of non-mortgage debt after meeting basic living expenses. The court's decision would be based on information submitted by the debtor regarding his or her existing financial information, including both current and future income.

If the consumer is unable to pay a reasonable portion of his or her debts out of future income -- as would be the case in a majority of cases according to Dr. Johnson -- the consumer's petition in Chapter 7 would be approved. All debts would then be totally discharged.

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If, however, the debtor can pay a reasonable portion of his or her debt out of future income -- after considering amounts needed for the debtor's support and that of his or her family -- the petition to discharge all debts would be dismissed. This produces nothing more than preventing a debtor who needs some relief from obtaining a complete release from all debts. These consumers, instead, would have the option to seek the measure of relief that is appropriate for their particular situations by filing under Chapter 13 of the Bankruptcy Code.

Second: Require A Reasonable Repayment Amount Under Chapter 13

By amending Chapter 7 in this way, the tremendous amount of debt that the debtor can repay but that is now being discharged, would not be automatically wiped out. That, however, is only the first of two essential steps that must be taken in order to prevent a shift of these costs to non-defaulting, paying consumers. The second critical step involves two amendments to Chapter 13.

The first of these two amendments would cure a major defect under the amended law that permits and may even encourage debtors to devote very little future income to repaying their creditors under Chapter 13. Under the new law, plans involving 0% dividends to unsecured creditors are not unusual and those with payments of 10% or less are plentiful.

In plans that involve no or very little return to the creditor, the bargain contemplated by the statutory pattern -- an exchange of an avoidance of the disruption caused by a liquidation bankruptcy for a reasonable dollar return to the debtor's creditors -- is not being met. Essentially, the absence of any standard in setting payment amounts produces

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a disguised Chapter 7 proceeding, except that the consumer is allowed to keep all of his or her assets and, in effect, continue without any change in lifestyle whatsoever.

In addition, Mr. Chairman, the absence of specific guidance has produced a disheartening array of percentage return plans for Chapter 13 creditors. Experience in different parts of the country illustrates the need for a more consistent standard. For example, in a recent six-month period in the Middle District of North Carolina, Greensboro Division, 415 Chapter 13 plans were confirmed. In 59.7% of the 36-month plans and 55.7% of the 60-month plans, unsecured creditors were to receive 100% payment on their claims. Moreover, 92% of the 36-month plans and 89.1% of the 60-month plans were to pay unsecured creditors at least 50%. Only .3 of 1% of all plans paid less than 10%.

Contrast this with the experience of the credit card operation of a major bank in the Midwest over a recent three-month period. Of the 263 Chapter 13 cases in which the proposed percentage of payout was known, the bank was to receive 100% in 37.3% of the cases, 50% or more in only 44% of the cases, and 10% or less in a startling 38.8% of the cases.

Why can debtors in North Carolina make significantly larger payments to creditors? This vast contrast cannot be explained on the basis of geography or demographics. The Midwest bank's figures are taken from a national card base not a local group. The difference can only be explained by the application of different standards by different judges.

In summary, a review of the actions of various courts -- presumably being presented with similar factual cases -- demonstrates that the shape of the plans being presented in

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these proceedings depends more upon where and before whom they are brought than upon a supposed national bankruptcy policy as reflected in the statute.

The necessary starting point in analyzing the "under-payment" problem is a recognition, as noted above, that the use of bankruptcy should be limited to those who actually need it. Unless some threshold test is to be applied in determining access to the bankruptcy process -- unlikely to provide relief since most courts undoubtedly would be reluctant to deny access to the courts to any consumer -- the barrier to use and potential abuse of the bankruptcy system must be an individual's reluctance to enter the system. This is not to say that a barrier should be erected that prevents consumers with significant economic problems from using this relief mechanism. Under the current provisions of Chapter 13, however, there are virtually no disincentives attached to this form of filing. Debts are erased, the consumer often pays little or nothing to unsecured creditors, and the debtor's property, furnishings and living quarters remain unchanged and undisturbed. In effect, the current law suggests absolutely no reason that consumers who would rather not pay their debts should not file a Chapter 13 proceeding.

In part, this has caused some to encourage consumers to file under Chapter 13 on the basis that they are simply debt consolidation proceedings without further significance. According to one tape recording that is available by calling a number provided in a West Coast newspaper advertisement, in response to a question "Is Chapter 13 a bankruptcy?", the answer given is,

> No. It is only a debt consolidation plan similar to a bank or finance company

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> debt or consolidaton loan. The difference is that you do not have to pay 18% to 36% interest per year to consolidate your bills, the court charges only 3-1/3% per year.

It is that misperception of a Chapter 13 proceeding, as being nothing more than debt consolidation, that provides a powerful incentive for consumers to seek the protection of its provisions. Of course, it is not a traditional debt consolidation proceeding since they involve repaying the total amount of debt outstanding rather than a mere fraction. This is clearly not the case under many Chapter 13 plans today.

One very vivid demonstration of the impact of the new law was detailed by a bankruptcy judge in the Western District of Michigan. In an opinion, the judge compared the repayments in Chapter 13 plans filed in his court between the period preceeding the adoption of the new Act and a month after the new Act took effect. Under the old law 88% of the Chapter XIII plans filed in that court were 100% plans; under the new law, 5% of the plans were 100% plans. Perhaps more strikingly under the old law, only 2% of the cases filed involved payment schedules of 5% or less, while 53% of the cases fit into that category under the new law. This dramatic illustration should lay to rest any suggestions that it is just "business as usual" under the revised provisions of Chapter 13.

It should be noted that consumers who file these low payback plans in many cases do so even though they seem able to meet their debt burden. The result is that these consumers are in effect "using up" their ability to look to the federal law for protection in the event that they face real economic adversity. Those who are lulled into believing that a Chapter 13 proceeding is nothing more than a debt

consolidation plan may find to their distress that when unemployment, economic or health problems, or other troublesome situations present themselves, they have no recourse to protection under Chapter 7 of the federal bankruptcy laws. Insofar as these very low payout plans hide the true character and significance of a Chapter 13 filing, consumers are unable to weigh and balance carefully the disruptions and economic and social costs involved in filing them. Once again, the signficance of providing some disincentive clearly weighs in favor of requiring a more realistic plan of those who wish to avail themselves of these protection provisions.

The problems of no or low payment plans simply are not addressed in a meaningful way by the Act. Under the existing provisions there is a reference to plans being proposed "in good faith" which according to some, but by no means all, courts relates to the extent to which payments are being made. In some jurisdictions, however, the courts have refused to apply the good faith test in measuring whether a consumer is making a fair and reasonable payment. Even where such a test is being applied, we would submit that "good faith" is simply too vague a concept to provide meaningful guidance to the courts, the creditor community or consumers themselves.

In order to promote uniformity and the implementation of a national policy, a more specific test should be devised. The Associations would submit that debtors should be required to pay as much as possible after the debtor has provided support for himself and his family.

Proposed plans that fail to meet these tests should not be afforded the safe harbor provided by Chapter 13. There should be a basic recognition that consumers who wish to

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enjoy the benefits of a Chapter 13 plan should have to make their creditors who finance those benefits considerably more whole than is now the case.

In short, the plans that have been produced under Chapter 13 have been repayment plans only in the most technical sense. So long as the federal law permits anyone to file at any time without losing property, rights, assets, or any other favorable aspects of their lifestyles, Chapter 13 will continue to provide a significant and unacceptable loophole in the bankruptcy system.

Third: Require That Payments Under Chapter 13 Be Made Over A Reasonable Period

The second amendment to Chapter 13 involves the related problem of the length of time over which the plan is paid out. The current law contemplates maximum payout periods of three years, except in extraordinary circumstances when the payout might extend for as long as five years. In fact, courts have been permitting considerably shorter payout periods without indentifying any signficant justification. As with the question of the payout amount, this issue, too, goes to the very nature of a Chapter 13 proceeding as an alternative bankruptcy choice.

Quite clearly, Chapter 13 involves a fundamental decision to permit consumers to look to their future earning power as a way of avoiding the more drastic consequences of a liquidation bankruptcy. Once again that trade-off is fair and equitable only if the trade-off involves a fair measure of return to the creditors involved. If the theory is that future income is to be used to meet the consumer's debt, it becomes of critical importance that the period during which that income is to be made available be reasonable.

A consumer should not be able to trade all outstanding

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debts for a very short-term allocation of earning power. Rather, Congress should clearly establish a reasonable period during which the plan is to take place. Given the current use of the three- to five-year period and the tendency in recent years to extend terms on various types of consumer debt, a reasonable solution would be to tie the amount of the dividend to unsecured creditors to the term of the plan. For example, we would argue that plans of under five years be permitted, but only where at least 70% of the claims of unsecured creditors are paid.

In any event, plans should be paid out over at least a three-year period with a provision that when appropriate to insure a reasonable return to all creditors, plans should be extended for an additional two years or a total term of five years. This would recognize both the debtor's interest in having some definite period during which to pay off the creditor, but at the same time, permit the court to look at the amount actually being received by the creditors and the period of time necessary in order to assure a reasonable return to the debtor's creditors.

The Three Amendments Are Inextricably Interrelated

It cannot be overemphasized that this triad of amendments -- one to Chapter 7 and two to Chapter 13 -- is completely interrelated. Since Chapter 7 and Chapter 13 present alternatives to consumers, to change one without the other simply unbalances the system. Insofar as there is a recognition that consumers should not be able to shed debts that they can afford to repay -- and, therefore a decision that these debtors should not be in Chapter 7 -- that policy decision must also be reflected by assuring that result when the debtor files under Chapter 13.

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Moreover, only by modifying both of these alternative choices is it possible to make certain that consumers who need relief -- whether complete or partial -- are able to obtain relief without imposing inappropriate costs on other consumers of credit services. Considering either of these two chapters in isolation from the other creates the possibility that various fact situations might "fall in a crack" between the two chapters. Quite simply, a failure to recognize the close relationship between these two chapters may fail to assure reasonable relief tempered with fairness to consumers who pay their debts -- and must shoulder the losses caused by those who do not. Affordable debts now totalling $1.6 billion a year, should be paid by those who have incurred them. That sound public policy can be effectuated only by amending both Chapter 7 and Chapter 13 as described above.

Conclusion

Mr. Chairman, the American Bankers Association and The Consumer Bankers Association would like to join with all other segments of the creditor community in urging that Congress reassess certain portions of the Bankruptcy Reform Act of 1978 in light of the experience to date under that law. The most critical of these concerns involves the treatment of debt that filing debtors are able to repay.

Only through immediate Congressional action to amend Chapter 7 and Chapter 13, will it be possible to assure a more reasonable and responsible allocation of economic and social costs for all participants in the credit system.

Thank you for providing us with this opportunity to comment on the pressing need for bankruptcy reform.

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Prepared Statement of Donald V. Beall

Good day. My name is Donald Beall. I am manager of the NASA Federal Credit Union in Beltsville, Maryland, and a member of the Credit Union National Association, Inc. Task Force on Bankruptcy.

The Credit Union National Association, Inc. (CUNA) represents more than 20,000 of the nation's state and federally chartered credit unions through 52 member credit union leagues. These leagues are located in each of the states and the District of Columbia and Puerto Rico. America's credit unions serve more than 45 million citizens. The National Association of Federal Credit Unions (NAFCU) is the only national trade association exclusively serving the more than 12,000 federal credit unions.

I am pleased to testify on behalf of the Credit Union National Association and the National Association of Federal Credit Unions in support of legislation that will address a number of the major problems that have plagued credit unions and other consumer lenders since the new Bankruptcy Code became effective. In particular, my comments address the need to include future income in considering whether an individual qualifies for Chapter 7 relief and the need to add a best-effort test to court evaluations of Chapter 13 plans.

Credit unions support the concept of a fresh start for the debtor who really needs such relief. However, each loss occasioned by a member's bankruptcy is shared by all of the members. These members have placed their funds in the credit union to be lent to each other. It is most disheartening to see this cooperative lending jeopardized by members who, for various reasons unrelated to true economic need, are enticed into the readily available relief of the new Bankruptcy Code.

Even in the most difficult situations, credit unions have continued to make credit available at reasonable rates to their member-owners. For instance, in the Depression, when thousands

of banks closed, not a single credit union depositor lost a penny of their funds invested in a credit union. Credit unions have also filled the gap when plants close and lay-offs have occurred by refinancing debts or extending existing loan payment schedules so that members could continue to meet their obligations. The tremendous increase in the number of bankruptcies since 1979 is a new, destabilizing factor that may result in significant adjustments in the way credit unions lend.

I manage the NASA Federal Credit Union. It has approximately 19,000 members who are employed by or related to employees of the Space Agency. Since October 1979, the effective date of the new Code, 75 NASA employees that are credit union members have sought relief under Chapter 7 and Chapter 13. In 1978, there were only 7 bankruptcy petitions filed.

Actual cases involving credit union members best illustrate the problem. In addition to examples from NASA Federal Credit Union, I will cite examples from the Essex Division Telephone Federal Credit Union in Irvington, New Jersey. Its manager, George Jones, is also a member of CUNA's Bankruptcy Task Force and provided a number of examples from his credit union to the House Judiciary Committee. Due to conflicting scheduling requirements, Mr. Jones is not joining me today; however, I am including several examples of petitions from the Essex Division Telephone Federal Credit Union which illustrate the problem extremely well.

The telephone employees federal credit union has approximately 4200 members. Fifty-two of these have declared bankruptcy under the new Act. The rate of incidence of bankruptcies among these two stable employment groups is roughly the same--high and alarming.

THRESHOLD TEST

In testimony last spring, CUNA provided the Committee with data from the Defense Credit Union Counsel's survey on bankruptcy and also its own survey of over 1,400 credit unions. Both sets

of data showed that bankruptcies by credit union members have increased at an alarming rate since the adoption of the new law. In fact, according to the CUNA survey, over 56 percent of the loans charged off by credit unions in 1980 were due to losses attributable to bankruptcy.

Recently, the National Credit Union Administration, concerned by the impact of bankruptcies on credit unions, surveyed federal credit unions to determine the effect of the new Code on loan charge-offs. Excerpts from the report state:

- "The survey results suggest that in the year following the effective date of the new Bankruptcy Code, the number of loan charge-offs due to bankruptcy at Federal credit unions more than doubled, and the dollar amount of charge-offs increased 90%... [T]he dollar amount of charge-offs for all Federal credit unions totalled about $29 million. It is further estimated that about 53% of this total or about $15 million can be attributed to the more liberal provisions of the new Bankruptcy Code."
- "In order to protect their operations from such increases in charge-offs, Federal credit unions would have to increase their provisions for loan losses. This would raise their expenses and reduce their earnings."
- "The survey data on the characteristics of loans charged-off due to bankruptcy indicates that about half were line-of-credit loans or refinancings. Moreover, about 80% of the loans were either unsecured or were used-vehicle loans. Almost half of the charge-offs due to bankruptcy were loans used to pay bills."
- "...53% of the charge-offs due to bankruptcy were attributed to the more liberal provisions of the new Bankruptcy Code. In addition, about 30% were a result of poor lending practices, about 14% were a result of adverse economic conditions, and about 3% were a result of poor collection practices."

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Although the NCUA report does not make specific recommendations, it does state that "it may be desirable to establish minimum standards which must be met before a borrower may file a bankruptcy petition. Such standards could in some way be based on an assessment of a borrower's ability to meet obligations out of current and future income."

I am here, as a member of the CUNA Bankruptcy Task Force, to reinforce those findings as they relate to the issue of eligibility for bankruptcy relief. As I stated earlier, in preparing this testimony, I reviewed the files on members of NASA Federal Credit Union who had filed for bankruptcy under either Chapter 7 or Chapter 13. George Jones, manager of the Essex Division Telephone Federal Credit Union, made a similar study. This Committee has been presented with statistics which clearly show that some people who are filing for Chapter 7 relief do not need it. My personal experience bears this out as does the experience of George Jones.

The telephone company, whose employees are served by Essex Division Telephone Federal Credit Union, is one of the largest employers and has one of the most stable and highest salary levels in the State of New Jersey. There is no seasonal employment and employees are not subject to lay-offs. As is the case in most occupational common bond credit unions, the manager has known each member for their entire employment. Most employees of the telephone company, for instance, join the credit union shortly after they go to work there.

Let me emphasize that credit union managers generally know the people that are declaring bankruptcy better than their counterparts at other financial institutions. In the case of the Essex Division Telephone Federal Credit Union, each of the 52 members who declared bankruptcy was working every day. In many instances, if not most, those 52 people were in the upper and middle range levels of income at the telephone company. They were employed for a period of seven years or longer. And perhaps

the most difficult thing to understand is that these members were, without exception, all current in their credit union debts and many had substantial savings accounts.

Every day opening the mail becomes a real challenge for a credit union manager. Let me give you an example of the type of petitions that are received. These are from the United States Bankruptcy Court for New Jersey and we have not used the credit union member's name. In one recent Chapter 7 petition the debtor listed total assets of $4,215 with exempt property claimed in the sum of $4,215. The debtor listed $322 in secured debts and unsecured debts of $11,276. The total debts equalled $11,598.

According to the loan application, the debtor did not have a car or mortgage loan. The debtor is a professional with the telephone company with a substantial income. In situations like this, it would be very helpful to talk with the debtor to determine if a consolidation could be arranged. However, the automatic stay prevents contact with the debtor after the petition is filed.

The fact remains, the person is employed and has a continuing income that has not been interrupted. At the time the petition was filed, the debtor was current in debt repayment at the credit union.

The notice from the Bankruptcy Court states that no assets appear present and that it would be unnecessary for creditors to file claims. In this case, however, the outstanding balance on the loan was $1,493.12 and it was secured by shares in an account at the credit union of $1,094.95. Therefore, the credit union's loss is relatively small. Perhaps the most aggravating aspect of this particular bankruptcy was the fact that after the petition was filed and the automatic stay went into effect, the manager received a letter from the debtor's lawyer indicating that three payroll deductions had been made on the loan after the stay went into effect and that if the credit union did not turn the money over to the trustee, action would be brought to recover the payments.

Another example of a Chapter 7 by a member of the Essex Division Telephone Federal Credit Union listed total assets of $4,125 with an exempt claim of $4,125. The only debts listed were $7,146 in unsecured debts. The court notice states that there were no assets and that it was, therefore, unnecessary to file a claim. The debtor was employed at the time the petition was filed and was current on the debt at the credit union.

In this case the member called to indicate that a petition for bankruptcy had been filed. The debtor had told the lawyer that the debtor didn't want to include the debt to the credit union because the debtor wanted to continue to pay off the loan. The lawyer properly indicated that all of the debts had to be included.

In my own credit union an FAA employee, who was working at the time, applied for an FHA home improvement loan of $3,725.98 that was granted on May 15, 1981. Total debts listed on the application, including a secured auto loan at NASA Federal Credit Union equaled $7,551.48 with a $16,500 mortgage loan. Total scheduled debt payments, including the FHA loan, would have equalled $485. The applicant's spouse was also working. Clearly this was a good loan. The government agreed as well.

I received the bankruptcy notice dated 15 days after the FHA granted the loan. I have asked the court for the schedule of debts on two occasions but have not received it. Also, we filed a claim with FHA that has been honored. So, the cost of that loss is being borne by the taxpayer directly.

These examples are representative of the mail that credit union managers receive weekly. These petitions call into question whether the debtors really need a "fresh start." On a straight balance-sheet basis, the debtors qualify for relief. However, when one considers the fact that so many of these debtors have a continuing income, it is most disturbing that they should be granted unconditional relief from debts.

Other members of the panel have fully documented the fact

that today's creditors lend on the strength of future income. It should be apparent that the failure to consider future income as an asset when determining whether a debtor is eligible for "straight" bankruptcy under Chapter 7 dramatically increases the number of people that escape debt entirely without altering their basic lifestyle.

SUGGESTED CHANGES TO COMBAT ABUSE

An important first step in correcting the abuse of the "fresh start" principle of bankruptcy is to require the judge to consider employment and future income as factors relevant to the granting of "straight" bankruptcy relief. This will not deny Chapter 7 relief to anyone with economic burdens that are overwhelming. It will eliminate the attitude, a feeling, that the new Code has relief for the "asking." The trouble is that the relief really is almost that available.

The alternative for credit unions is to simply require that all loans be share-secured or that other adequate collateral be provided. This is dramatically different from the traditional credit union purpose of lending to our member-owners for provident and productive purposes on the strength of their major asset--continuing income.

By requiring consideration of future income, the Congress will be conforming the Bankruptcy Code requirements to modern lending practices. The result will not be a dramatic change in the total number of people who are eligible for relief under Chapter 7 and Chapter 13. These will still be available as relief for the necessitous debtor. I am firmly convinced that consideration by the court of future income will minimize the abuses I have seen reflected in the bankruptcy petitions filed against credit unions.

CHAPTER 13 ABUSES

Best Effort Standard.

Under the Code, Chapter 13 plans must be "in good faith" and must propose to pay the unsecured creditor at least as much as

would be received in straight bankruptcy. Since the Code does not define "good faith," debtors have proposed plans paying as little as one percent to unsecured creditors. This satisfies the Code requirements, if read literally, and some courts have accepted these plans. We appreciate the fact that this Subcommittee is re-examining the "good faith" requirement of a Chapter 13 plan. We urge inclusion of a requirement that a plan must represent the best effort of a debtor. A court, in deciding what constitutes a consumer's best effort, will need to examine the complete financial picture of the debtor and must, therefore, have the debtor's income, living expenses and projected expenses before it. This is the type of judgment that courts are completely familiar with and should impose no hardship on debtors electing to seek Chapter 13 relief.

Length of Plan.

The present Code provisions call for a Chapter 13 plan to last three years and, with the court's permission, up to five years. This reflects a determination by the Bankruptcy Commission in the early 1970s that three years is an adequate time to repay most consumer installment debts. However, in the time between the deliberations by the Bankruptcy Commission and the adoption of the Code, dramatic changes took place in the lending patterns involving consumer debt. Automobile loans, traditionally 36 months in length, were expanded to 48 and even 60 months in length.

These longer term, consumer-debt obligations arose out of a willingness by consumers to incur debt over a longer period of time. Given this change in consumer attitudes about consumer debt, we would suggest that the Code be revised to have repayments generally run over a period of five years. Since consumer debt was originally incurred with the intent of paying it out of future income, this change in the Code would conform more closely to the consumer's expectations in filing a Chapter 13 plan. In essence, the consumer filing a Chapter 13

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plan expects to repay all or a portion of debt out of future income. The safety valve of court re-examination on the basis of changed circumstances is always present. Therefore, it is not unreasonable to provide for longer repayment periods in Chapter 13 plans.

The provision of a longer Chapter 13 repayment period should not preclude a consumer from offering a repayment plan over a shorter period of time. Where a consumer would agree to pay at least a set percentage of allowed unsecured claims, shorter plans should be approved at the discretion of the court. We believe that a 70 percent minimum-payback schedule is reasonable. This is the figure chosen which permits persons who have received a Chapter 13 discharge to file a subsequent Chapter 7 petition within six years. Given the Congressional determination that 70 percent is a substantial commitment to repayment, we would suggest that this figure be incorporated into any minimum standard for debt repayment in less than a five-year period.

CONCLUSION

As a member of the CUNA Bankruptcy Task Force and a participant in the work of the "National Coalition for Bankruptcy Reform," I can assure the members of the Subcommittee that the reforms addressed by this panel this morning are important to all credit grantors and consumers as well. The Code should be amended to balance the protection of the truly necessitous debtor with the rights of the credit union members who repay their loans and of credit unions that do not want to pass these bankruptcy losses on to members in the form of higher loan rates and lower returns on savings. Establishing a "threshold" test that considers income as an asset is a critical step in restoring the balance. We also urge adoption of the proposed Chapter 13 changes.

We appreciate this opportunity to address these issues. I would be pleased to answer any questions.

PREPARED STATEMENT OF ROBERT B. EVANS

My name is Robert B. Evans. I am Senior Vice President and General Counsel of the National Consumer Finance Association (NCFA).* NCFA is a participant in the National Coalition for Bankruptcy Reform ("Bankruptcy Coalition") and is in agreement with its objectives and the recommendations presented to this Subcommittee on April 3rd of this year.

We welcome this opportunity to comment on the proposed threshold entry requirement to chapter 7 which uses anticipated future income as the test. Such a requirement is long overdue and - if the objectives of the 1978 Code reformers are ever to be realized - is absolutely essential to the perpetuation of the Code as a socially acceptable, equitable form of debtor relief. This is so because a majority of the bankruptcy courts have only given lip service to express Congressional "premise" of the 1978 reform effort as set forth in the report accompanying H.R. 8200:

> The premises of the bill with respect to consumer bankruptcy are that the use of the bankruptcy law should be a last resort; that if it is used debtors should attempt repayment under chapter 13, Adjustment of Debts of an Individual with Regular Income; and finally, whether the debtor uses chapter 7, Liquidation, or chapter 13, Adjustment of debts of an Individual, bankruptcy relief should be effective, and should provide the debtor with a fresh start.**

With this, we heartily agree. The problem is - and has been - that very few people pay any attention to it.

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*Organized in 1916, NCFA is the national trade association of companies engaged in the consumer credit business. NCFA represents over 700 companies operating more than 15,000 offices serving the public throughout the country. The membership of NCFA is highly diversified ranging from single small loan offices to substantial nationwide financial services organizations engaged in unsecured direct lending, second mortgage lending and the financing of the sale of durable goods. The consumer finance industry accounts for approximately one-fourth of all consumer credit extended or approximately $75 billion of the $300 plus billion outstanding.

**House Report No. 95-595, 95th Cong., 1st Sess., 118 (1977).

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This is the crux of the problem we address today: although we have a means through which people with ability to pay can do so if they choose - chapter 13 - they have very little economic incentive to use it. Put another way, debtors have very little disincentive to avoid chapter 7. As the recent Purdue Bankruptcy study indicates, only 5% of the debtors in chapter 7 have non-exempt assets subject to liquidation.

It makes little sense then, to talk about tightening chapter 13, unless people with the ability to pay have reason to avoid chapter 7.

How chapter 13 works today. First, does it work at all? Not much, in many districts. One would think - from the foregoing report language - that chapter 13 would be extensively employed. In other words, chapter 13 would be uniform in its use as well as its application in the bankruptcy courts. However, cursory examination of the midyear 1981 report on Bankruptcies* shows that in many districts it has only token acceptance. Its use is not encouraged and its provisions as drafted do not require its application in appropriate cases. Compare these districts:

	Voluntary Cases 07/01/80 through 06/30/81		
District	Chap. 7	Chap. 13	Ch. 13 as % of all cases
Maryland	4907	292	5.6%
North Carolina (middle)	682	2304	77.2%
North Carolina (all)	2657	5463	67.3%

Even within the same district, two judges sitting in different courts will exhibit very different attitudes toward chapter 13. For instance:

	Voluntary Cases 07/01/80 through 06/30/81		
	Chap. 7	Chap. 13	Ch. 13 as % of all cases
Tennessee (eastern)			
Judge Kelley	1018	1436	58.5%
Judge Bare	1608	170	9.6%

*Administration Office of the United States Courts, Bankruptcy Division, July 31, 1981.

Are debtors in Maryland or Judge Bare's sub-district "poorer" than those in North Carolina or in Judge Kelley's sub-district? Of course not.

Clearly, many debtors in straight bankruptcy throughout the land could be fashioning repayment plans in chapter 13 but have no incentive to do so. It is obvious also, that unless the court plays a strong part in encouraging chapter 13, or, conversely, (discouraging chapter 7 liquidations), the only debtors who have the economic incentive to elect chapter 13 are those with non-exempt property to protect or non-dischargeable debts to avoid.

The second question we would raise about chapter 13 is this: is it fairly, efficiently, and uniformly administered? This time the answer has to be a qualified "yes;" but again, unfortunately, vague and inadequate standards in the law have seriously undermined effective administration of that chapter. To catalog them: 1) long delays in confirmation of plans delay the commencement of payments; this can be remedied by requiring commencement of payments upon filing or soon thereafter; 2) courts confirm plans that provide for repayment of far less than the debtor could afford to pay; this can be cured by requiring a debtor to devote income in excess of debtor's own and dependents' living needs to the repayment of debt ("disposable income" standard); 3) the 3 year period now permitted for repayment (longer, only for "cause") is inadequate. As a current study of 35,000 chapter 13 debtors done by Claude Rice, Esq. shows, very little unsecured debt - 28% on the average - is repaid in 36 month plans. Over 70% would be repaid in 48 months and 100% in about 56 months. Trustee's fees, secured claims, other priority claims... these all "crowd out" the repayment of unsecured debt in 36 month plans. The answer lies in longer permissable payout periods; a maximum of 60 months is suggested. This would accommodate the longer

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maturity obligations which consumers are incurring today (average finance company new car maturities are 45.5 months for the period August, 1980 through August, 1981; Source: Federal Reserve Board).

The Impact of an Ineffective Bankruptcy Code on Consumer Credit

These deficiencies in the Bankruptcy Code are more than mere nuisances; they are causing creditors to make business decisions today that will affect the ability of consumers to obtain credit for many years to come. For instance, NCFA members have long been extenders of cash credit to blue-collar and other lower to middle income workers. You can see from the attached tables their customers are predominantly in the $9,000-24,000 income range, are young, and are most heavily represented in the laboring and craft trades (see tables 1 and 2).

These people are not for the most part homeowners, but are renters. Many of them are just getting established in their first jobs. They are extremely vulnerable to business conditions. It is not inappropriate therefore to assert that much (and I emphasize "much") of the problem that NCFA's members and other credit extenders are experiencing is attributable to economic factors. After all, we extend credit primarily on future income and, if our customers find their income expectations upset by external economic circumstances then we must expect to suffer the consequences through increased bad debt expense. We accept that as part of the credit risk.

If economic conditions were the only explanation for the increase in bankruptcies creditors would have little reason to complain. However, we now have convincing evidence in a study of 1,199 bankrupts performed by Purdue University's Credit Research Center which indicates that as many as 40% of the debtors taking straight bankruptcy could

have paid all or a substantial portion of their debts had they elected to do so outside of bankruptcy or in a chapter 13 proceeding. The study also suggests that about one-fourth ($1.5 billion) of the non-business, non-mortgage debt which will be scheduled in bankruptcy this year could have been paid.

Clearly, an unsecured lender cannot protect itself from a debtor who could pay out of future income, but who can elect at any time not to pay by taking straight bankruptcy. As long as chapter 7 looks only to non-exempt assets and ignores the role of future income in extending consumer credit, it will be a haven for debtors with disposable income but who have no non-exempt assets at risk.

It is obvious that creditors can respond to temporary economic adversity by: 1) increasing the cost of credit, where possible, or 2) denying credit to all but the most creditworthy. Faced however, with the additional problem of debtors legally avoiding repayment through chapter 7, and having no way to identify such debtors in advance, many creditors are now seeking equity positions in property of the consumer, generally his residence. As the table below indicates, this is exactly what NCFA members are doing

Estimated Second Mortgage Loans and Other Personal Loans Outstanding at Finance Companies, Year End 1975-1979

	In millions of dollars except as indicated by percent					
	1975	1976	1977	1978	1979	1980
Personal Loans (NCFA Survey)						
Secured by Second Mortgages	$1,050	$1,783	$ 2,545	$3,819	$8,226	$8,920
Other	$5,687	$9,553	$10,422	$10,474	$13,397	$8,203
Total (companies reporting these categories separately)	$6,737	$11,336	$12,967	$14,293	$21,623	$17,123
Percent Second Mortgages of Total Personal Loans (NCFA Survey)	15.6%	15.7%	19.6%	26.7%	38.0%	52.1%
Estimated Total Outstanding Second Mortgages (Calculated from Total Personal Loans Reported by the Federal Reserve)	$2,694	$2,910	$4,163	$6,616	$11,638	$16,447
Personal Loans - Unsecured or Secured by other than Real Estate	$14,573	$15,627	$17,076	$18,164	$18,956	$15,126
Personal Loans Reported by the Federal Reserve	$17,267	$18,537	$21,239	$24,780	$30,594	$31,573
NOTE: Percent of Federal Reserve personal loan estimates reported in NCFA surveys	39.0%	61.2%	61.1%	57.7%	70.7%	54.2%

today. Although personal loans outstanding increased by roughly $1 billion in 1980, there was a net liquidation of $4 billion in unsecured loans and a net addition of $5 billion in second mortgage secured loans.

A recent poll of several of NCFA's largest members confirms this trend:

Ratio: Loans Secured By Real Estate To All Loans	1980	1981
Household Finance	34%	50%
Beneficial	35%	53%
Associates	38%	49%
Security Pacific Finance	70%	79%

All of this is being accomplished at the expense of denying credit to many hundreds of thousands of consumers with whom these members have been doing business simply because they do not have adequate security to offer for a loan.

Probably nothing can be done to prevent this massive shift to secured lending. At the same time however, retailers and credit card issuers cannot readily acquire security, and will have to resort to other means to protect their assets. This means, inevitably, increased credit charges, increased downpayments on larger items and even credit rejection for many consumers.

This brings to the forefront the core social policy question this Committee must address: what role, if any, should future income play in determining the scope of bankruptcy relief. Former Bankruptcy Judge Conrad Cyr (now Federal District Court Judge) states the issue quite well in his recent article on "Ability to Pay" in Chapter 13. He states at page 280:

> "Consumer credit is seldom extended in reliance upon the debtor's present net worth, i.e. the present value of unencumbered assets, but on the basis of

> future income. Although the credit bargain made in the marketplace may have been sound and equitable in all respects, chapter 13 presently permits the debtor, unilaterally, on demand and without demonstrated need, to alter or nullify the entire credit transaction, notwithstanding the fact that the ability of the debtor to pay has not deteriorated and may even have improved.
>
> A legal procedure at such cross purposes with the economy it regulates runs the risk of falling into disuse due to its own irrelevance, or, more importantly, threatens actual deflection of powerful economic forces at work in the consumer credit marketplace. The devastating social and economic impact of a return to pre-World War II net worth consumer credit extension policies needs no elaboration. It would seem a sound policy to conform the involvency system to the economic system, especially since the reality is that consumer credit represents a primary driving force in American society.
>
> Additionally, there is little, if any, quarrel with the view that the law should encourage debtors voluntarily to repay their just obligations to the extent reasonably able to do so. The ethical premise upon which this near universal view is based is the core of our consumer credit system."*

Although Judge Cyr confines his observations to chapter 13, the ethical premise applys equally well to chapter 7, that is, if a debtor has the capacity to pay, he should pay.

The surest and best way to bring this about is to open chapter 7 only to those with little or no ability to pay. As the Purdue study indicates, probably 50 to 60% of those who take straight bankruptcy today would be unaffected. On the other hand, it appears that 30 to 40% have sufficient ability to repay so that they would not qualify; these debtors would either have to seek relief in chapter 13 or, if they did not need court protection, make their own arrangements with their creditors.

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*Cyr, The Chapter 13 "Good Faith" Tempest: An Analysis And Proposal For Change, 55 Am. Bankr. L.J. 271, 280 (1981).

Amendments to Chapter 13

Three amendments to chapter 13 are also needed. Commencement of payments upon filing, use of the "disposable income" concept as a measure of repayment, and a term of repayment of up to 60 months must be incorporated in chapter 13 if it is to work at all.

Anything less will not do. Consumer debt today is unsecured credit advanced against future income. Any statutory scheme which deprives the unsecured consumer creditor of a reasonable opportunity to participate in the debtor's future disposable income, in Judge Cyr's words "runs the risk of falling into disuse due to its own irrelevance."

TABLE 1

PERCENT DISTRIBUTION OF BORROWERS FROM FINANCE COMPANIES AND ALL HOUSEHOLDS, BY INCOME AND AGE GROUPS, 1979

	Borrowers from Finance Companies Percent of:		All Households Percent of:	
By Annual Income	Number of loans	Amount of loans	Number of Households	Amount household Income*
$6,000 or less	9.3	5.1	13.1 **	1.7 **
$6,001 to $9,000	17.6	11.5	16.4 **	6.3 **
$9,001 to $15,000	38.8	32.9	15.9 **	10.1 **
$15,001 to $24,000	26.3	34.1	26.4 **	26.7 **
Over $24,000	8.0	16.4	28.1 **	55.2 **
Total	100.0	100.0	100.0	100.0
By Age				
Less than 25 years	29.9	20.9	8.0	5.5
25 to 34 years	31.1	31.4	22.6	22.6
35 to 44 years	18.9	23.9	17.6	22.1
45 to 54 years	12.6	15.8	15.9	21.1
55 to 64 years	5.8	6.9	15.4	17.1
65 years and over	1.7	1.1	20.4	11.6
Total	100.0	100.0	100.0	100.0
Number in millions	14.8	-	79.1	-
Amount in billions of dollars	-	$ 29.9	-	$1,552.7

Source: NCFA Surveys and Bureau of the Census.

Note: Parts may not add to totals due to rounding.

* Amount of income by income levels is NCFA estimate.

** Under $5,000 in income in the first group, $5,000 to $9,999 in the second group, $10,000 to $14,999 in the third group, $15,000 to $24,999 in the fourth group, and $25,000 and over in the fifth group.

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TABLE 2

PERCENT DISTRIBUTION OF THE NUMBER OF LOANS MADE BY BORROWER CHARACTERISTICS, SELECTED YEARS, 1970-1979

	1970	1975	1977	1978	1979
By Monthly Income of Borrower					
$500 or less	38.4	12.2	13.0	4.9	9.3
$500.01 to $750	32.7	28.9	20.3	17.3	17.6
$750.01 to $1,000	17.7	22.0	18.4	18.7	20.8
$1000.01 to $1,250	11.2*	36.9*	48.3*	59.1*	18.0
$1250.01 to $2,000	na	na	na	na	26.3
Over $2,000	na	na	na	na	8.0
Total	100.0	100.0	100.0	100.0	100.0
By Age of Borrower					
Less than 25 years	14.1	18.0	17.2	18.8	29.9
25 to 34 years	31.3	28.8	34.2	37.6	31.1
35 to 44 years	24.6	23.5	21.4	18.3	18.9
45 to 54 years	19.6	23.1	16.6	15.5	12.6
55 to 64 years	9.3	6.0	9.0	8.3	5.8
65 years and over	1.1	0.6	1.6	1.5	1.7
Total	100.0	100.0	100.0	100.0	100.0
By Occupation of Borrower					
Proprietors, managers and office workers, excluding farm	5.5	na	na	6.2	na
Craftsmen, foremen and kindred workers	42.8	na	na	40.4	na
Operatives, laborers and kindred workers, including farm and mine	19.6	na	na	21.8	na
Clerical and kindred workers	6.1	na	na	7.8	na
Sales persons	2.8	na	na	2.5	na
School teachers	1.3	na	na	1.3	na
Professional and semi-professional workers, excluding teachers	2.0	na	na	1.7	na
Service workers, including government civilian and military personnel	14.2	na	na	13.8	na
Unemployed, occupations not reported and miscellaneous	5.7	na	na	4.5	na
Total	100.0	na	na	100.0	na

Source: Annual Research Report on Finance Companies for the respective years from data obtained by NCFA surveys.
Note: Parts may not add to totals due to rounding.
na: Not available
* Over $1,000

PREPARED STATEMENT OF RAYMOND A. KENNEDY

Mr. Chairman, and distinguished members of the Subcommittee on Courts, I am Raymond A. Kennedy, Vice President and General Credit Manager for Sears, Roebuck and Co. I am testifying today on behalf of the American Retail Federation (ARF), the National Retail Merchants Association (NRMA), and as a member of a coalition of creditors for bankruptcy reform. I applaud the Subcommittee's efforts to address problems caused by the bankruptcy code and appreciate the opportunity to present the views of the retail community on this vital subject.

By way of background, ARF membership consists of 33 national retail trade associations, 50 state retail associations, the Greater Washington Board of Trade, as well as corporate members. Through its members, ARF represents more than one million retail establishments.

NRMA is a non-profit national trade association with over 3,500 corporate members. These businesses range in size from small specialty shops to the Nation's largest department stores, although the majority

of NRMA's members are small businesses with sales under $1 million annually. NRMA's members operate more than 40,000 department, chain and specialty stores and account for over 100 billion dollars in sales annually, at least half of which are credit sales.

Almost all retailers represented through ARF and NRMA offer or extend consumer credit in some form and are therefore vitally concerned with their rights and obligations as creditors in bankruptcy proceedings. Both large and small companies alike have experienced substantial losses due to consumer bankruptcies. As one example, Sears losses from bankruptcy increased over 120% from 1979 to 1980 - the first full year of the bankruptcy code. Other retailers experienced similar staggering losses.

Indications of the Problem

As you might expect, these losses precipitated a hard look by creditors at the financial circumstances of their customers who filed in bankruptcy. We found the traditional problems of unemployment, inflation, marital problems, large unexpected expenses, and overspending. But, we also found a new and substantial class of debtors - one different from the traditional debtor - and one that, quite frankly, is the source of grave concern within the creditor community.

These persons are current on their required monthly payments, have had little or no previous history of delinquency, and may even have additional credit available on the account at the time the bankruptcy notice is received by the creditor. Certainly this debtor profile does not fit a creditor's traditional notion of financial distress.

This class of debtors comprises a disturbingly large portion of bankruptcy cases. Data collected by Montgomery Ward indicates that nearly 13% of the accounts taken as a loss due to bankruptcy are up to date at the time the bankruptcy notice is received. My company, Sears, Roebuck and Co., conducted a survey of bankruptcies in 13 states that included over 9,200 cases. Our data shows that in excess of 13% of the accounts are current or paid ahead at the time the bankruptcy notice is received. Federated Department Stores conducted a similar study which indicated an increase of over 157% in the number of accounts that were current at the time of bankruptcy from 1979 to 1980.

Debtors Choose Bankruptcy Discharge Over Repayment

These statistics indicate the large number of debtors who are

having affordable debts discharged in bankruptcy. There are debts which could be repaid in whole or in part through a commitment of a portion of the debtor's future income. I would like to review some of the reasons we believe consumers are choosing the bankruptcy alternative rather than attempting to fashion repayment plans. To a certain extent the answer may be due to changes to the bankruptcy code enacted by Congress in 1978 - the increased protections granted to debtors in contrast with the inability of creditors to exercise their rights without onerous and costly procedures.

However, an even more significant factor in losses is the failure of the bankruptcy code to take into consideration the debtor's future income. Instead, the code adopts a wholly assets-based approach to bankruptcy relief. This is significant when one reviews the nature and make up of consumer credit today and the failure of the bankruptcy code to keep up with this changing market.

The make up of consumer credit has changed to a significant extent. This is illustrated by the different types of credit and the extent to which they are used. For example, one comparison can be drawn between the traditional 30 day accounts and revolving accounts which allow repayment over an extended period of time. In 1970 the 30 day accounts represented $9.2 billion dollars. By 1979, they had risen modestly to $12.8 billion dollars. On the other hand, outstanding debt on revolving accounts was $5.1 billion dollars in 1970 and increased over ten times that amount by 1979 to $55.3 billion dollars. 1/

More specifically, department store (as defined by the U.S. Bureau of Census) account receivables have followed the same trend. Taking the period of 1975 to 1979, outstanding balances on charge accounts that require full payment at the end of the customary billing period declined from 1.2 billion dollars to 1.1 billion dollars. During the same period, revolving accounts rose from 10.6 to 18.4 billion dollars.

An additional comparison can be drawn between open end - which is generally unsecured - credit and closed end, secured credit. This can be illustrated by the plans within Sears - as a case in point. In 1970, 40% of the outstanding credit account balances were financed on our closed end secured account. In 1980, less than 5% of credit outstanding was closed end credit. That is, the vast majority was on open end,

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1/ Source: U.S. Bureau of Census, Statistical Abstract of the U.S. 1980 (101st edition.) Washington, D.C., 1980. pp. 540, 841.

unsecured credit. When taken in perspective, these shifts in consumer credit have also caused an attitudinal change in the extension of credit. At one time, it was unheard of to extend credit to an individual without significant assets to secure the debt. In addition, sufficient income and a good repayment history on other credit obligations were essential. Therefore, a traditional balance sheet analysis of assets versus liability was conducted.

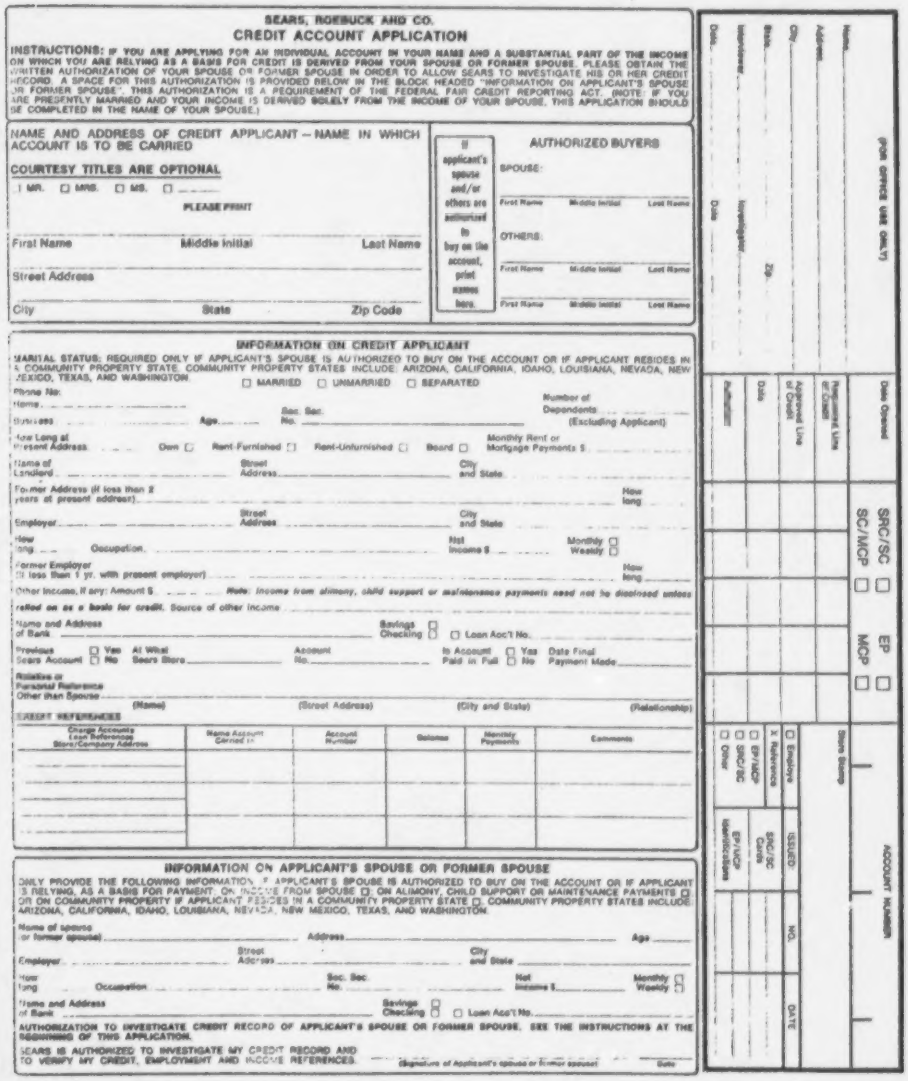
Today's credit manager looks instead to an individual's willingness and ability to repay out of future income. Since most accounts are unsecured, the main factor is to extend a reasonable line of credit to prevent any possibility of overobligation. This fact is graphically illustrated by copies of actual credit applications from several retailers which I have attached to my testimony. You will note that, except for future income, an applicant's assets are not requested.

While the qualities used to extend credit have shifted to meet the demand of the changing market, the bankruptcy code revisions have placed those changes in jeopardy. It is apparent that many of the revisions to the bankruptcy code in 1978 were meant to address the changing character of consumer credit. But one area that has not been addressed or revised since the bankruptcy law was first enacted is the assets-based approach to relief. For creditors, this is one of the areas most in need of updating. Where in the past, credit was granted solely on the basis of a debtor's ability to pledge assets as security, credit now is extended on the basis of the debtor's greatest asset - earnings potential. Where the bankruptcy law looks to the liquidation of assets to repay creditors, what is needed is the consideration of future income. Taken in concert with the added debtor protections passed in 1978, creditors have experienced the brunt of a growing imbalance between debtor and creditor considerations. This imbalance, we believe, has led to the growing losses from consumer bankruptcies.

It is my understanding that the Senate staff has developed an equitable solution to deal with this problem. That is, a solution which would preserve bankruptcy for those debtors in financial distress and needing relief. In addition, the proposal would address the situation where the debtor could afford to repay a reasonable portion of the outstanding debt out of future income. The retail credit industry strongly endorses this proposal. This Subcommittee and its staff are to be commended for their efforts to work out an equitable solution. I would urge that the future income approach be incorporated along with the other industry suggested changes for bankruptcy reform in a bill. Quick Congressional passage of these changes is badly needed.

In closing, I would like to note that future income is an extremely important proposal - both procedurally and substantively - but not the only problem for retailers in the bankruptcy code. The industry testified at your April hearing on these problems which are addressed by the proposed Bankruptcy Improvements Act of 1981. They would include - but are certainly not limited to - the "loading up" or pre-bankruptcy buying spree abuse, the problem of valuation, the voidable preference provisions, the federal exemptions, and Chapter 13 provisions. It is important, therefore, that the problems be addressed as a whole to avoid further imbalance from these reform efforts.

I thank the Subcommittee for the opportunity to present these matters for consideration. I will be more than happy to answer any questions or to follow up any questions with a written response.



SEARS, ROEBUCK AND CO.
CREDIT ACCOUNT APPLICATION

INSTRUCTIONS: IF YOU ARE APPLYING FOR AN INDIVIDUAL ACCOUNT IN YOUR NAME AND A SUBSTANTIAL PART OF THE INCOME ON WHICH YOU ARE RELYING AS A BASIS FOR CREDIT IS DERIVED FROM YOUR SPOUSE OR FORMER SPOUSE, PLEASE OBTAIN THE WRITTEN AUTHORIZATION OF YOUR SPOUSE OR FORMER SPOUSE IN ORDER TO ALLOW SEARS TO INVESTIGATE HIS OR HER CREDIT RECORD. A SPACE FOR THIS AUTHORIZATION IS PROVIDED BELOW IN THE BLOCK HEADED "INFORMATION ON APPLICANT'S SPOUSE OR FORMER SPOUSE". THIS AUTHORIZATION IS A REQUIREMENT OF THE FEDERAL FAIR CREDIT REPORTING ACT. (NOTE: IF YOU ARE PRESENTLY MARRIED AND YOUR INCOME IS DERIVED SOLELY FROM THE INCOME OF YOUR SPOUSE, THIS APPLICATION SHOULD BE COMPLETED IN THE NAME OF YOUR SPOUSE.)

NAME AND ADDRESS OF CREDIT APPLICANT – NAME IN WHICH ACCOUNT IS TO BE CARRIED

COURTESY TITLES ARE OPTIONAL

☐ MR. ☐ MRS. ☐ MS. ☐ _____

PLEASE PRINT

First Name | Middle Initial | Last Name

Street Address

City | State | Zip Code

If applicant's spouse and/or others are authorized to buy on the account, print names here.

AUTHORIZED BUYERS

SPOUSE: First Name | Middle Initial | Last Name

OTHERS: First Name | Middle Initial | Last Name

First Name | Middle Initial | Last Name

INFORMATION ON CREDIT APPLICANT

MARITAL STATUS: REQUIRED ONLY IF APPLICANT'S SPOUSE IS AUTHORIZED TO BUY ON THE ACCOUNT OR IF APPLICANT RESIDES IN A COMMUNITY PROPERTY STATE. COMMUNITY PROPERTY STATES INCLUDE: ARIZONA, CALIFORNIA, IDAHO, LOUISIANA, NEVADA, NEW MEXICO, TEXAS, AND WASHINGTON. ☐ MARRIED ☐ UNMARRIED ☐ SEPARATED

Phone No: Home _____ Business _____ Age _____ Soc. Sec. No. _____ Number of Dependents _____ (Excluding Applicant)

How Long at Present Address _____ Own ☐ Rent-Furnished ☐ Rent-Unfurnished ☐ Board ☐ Monthly Rent or Mortgage Payments $ _____

Name of Landlord _____ Street Address _____ City and State _____

Former Address (if less than 2 years at present address) _____ How long _____

Employer _____ Street Address _____ City and State _____

How long _____ Occupation _____ Net Income $ _____ Monthly ☐ Weekly ☐

Former Employer (if less than 1 yr. with present employer) _____ How long _____

Other Income, if any: Amount $ _____ Note: Income from alimony, child support or maintenance payments need not be disclosed unless relied on as a basis for credit. Source of other income _____

Name and Address of Bank _____ Savings ☐ Checking ☐ ☐ Loan Acc't No. _____

Previous Sears Account ☐ Yes ☐ No At What Sears Store _____ Account No. _____ Is Account Paid in Full ☐ Yes ☐ No Date Final Payment Made _____

Relative or Personal Reference Other than Spouse _____ (Name) (Street Address) (City and State) (Relationship)

CREDIT REFERENCES

Charge Accounts Loan References Store/Company Address	Name Account Carried In	Account Number	Balance	Monthly Payments	Comments

INFORMATION ON APPLICANT'S SPOUSE OR FORMER SPOUSE

ONLY PROVIDE THE FOLLOWING INFORMATION IF APPLICANT'S SPOUSE IS AUTHORIZED TO BUY ON THE ACCOUNT OR IF APPLICANT IS RELYING, AS A BASIS FOR PAYMENT, ON INCOME FROM SPOUSE ☐, ON ALIMONY, CHILD SUPPORT OR MAINTENANCE PAYMENTS ☐, OR ON COMMUNITY PROPERTY IF APPLICANT RESIDES IN A COMMUNITY PROPERTY STATE ☐. COMMUNITY PROPERTY STATES INCLUDE: ARIZONA, CALIFORNIA, IDAHO, LOUISIANA, NEVADA, NEW MEXICO, TEXAS, AND WASHINGTON.

Name of spouse or former spouse _____ Address _____ Age _____

Employer _____ Street Address _____ City and State _____

How long _____ Occupation _____ Soc. Sec. No. _____ Net Income $ _____ Monthly ☐ Weekly ☐

Name and Address of Bank _____ Savings ☐ Checking ☐ ☐ Loan Acc't No. _____

AUTHORIZATION TO INVESTIGATE CREDIT RECORD OF APPLICANT'S SPOUSE OR FORMER SPOUSE. SEE THE INSTRUCTIONS AT THE BEGINNING OF THIS APPLICATION.

SEARS IS AUTHORIZED TO INVESTIGATE MY CREDIT RECORD AND TO VERIFY MY CREDIT, EMPLOYMENT AND INCOME REFERENCES. _____ (Signature of Applicant's spouse or former spouse) _____ Date

(FOR OFFICE USE ONLY)

Name _____ Address _____ City _____ Zip _____ Block _____ Investigator _____ Date _____ Authorized _____ Date _____ Approved Line of Credit _____ Requested Line of Credit _____ Date Opened

SRC/SC ☐ SC/MCP ☐ EP ☐ MCP ☐

Store Stamp

☐ Employee ☐ X Reference ☐ EP/MCP ☐ SRC/SC ☐ Other

ACCOUNT NUMBER

EP/MCP Manufacturer | SRC/SC Cards ISSUED | NO. | DATE

(113)46

Form 300 821 Rev. 9/80

HECHTS

SOLICITED BY ASSOC NAME

NUMBER

Application for Credit

IMPORTANT PLEASE READ CAREFULLY

WASHINGTON SHOPPING PLATE NO. | TYPE | STAT | WHOSE | ASSOC | CR LIM | SOL

BALTIMORE SHOPPING PLATE NO. | ASSOCIATE NUMBER (Employee Acct. Only)

APPROVED | DECLINED | NOTIFIED

DATE OF APPLICATION MONTH DAY YEAR

BRANCH STORE

FOR STORE USE

MEMO $

ON PAY REQ $

MERCHANDISE

APPROVED BY

1 13
2 14
3 15
4 16
5 17
6 18
7 19
8 20
9 21
10 22
11 23
12

☐ **INDIVIDUAL ACCOUNT**–IF you are applying for an individual account in your own name and are relying on your income or assets and not the income or assets of another person as the basis for repayment of the credit requested.

☐ **JOINT ACCOUNT**–IF you are applying for a joint account and are relying on your income or assets and the income or assets of the joint applicant as the basis for repayment of the credit requested. Provide information about the joint applicant in the shaded area.

☐ **INDIVIDUAL ACCOUNT WITH AUTHORIZED USER**–IF you are applying for an individual account but a spouse or other person is to be permitted use of the account. Provide information about spouse or other user in the shaded area.

☐ **OTHER**–IF you are applying for an individual account in your own name but are relying on income from alimony, child support, separate maintenance or the income or assets of another person as the basis for repayment of the credit requested. Provide information about the other person in the shaded area.

ACCOUNT AND CHARGE CARDS TO BE IN NAME OF

HOME PHONE

FIRST NAME | MIDDLE INITIAL | LAST NAME | HOW LONG AT PRESENT ADDRESS | OWN / RENT / OTHER | AGE | NUMBER OF DEPENDENTS

STREET ADDRESS | APARTMENT NUMBER

CITY | STATE | ZIP CODE | SOCIAL SECURITY NUMBER

NAME OF NEAREST RELATIVE NOT LIVING WITH YOU | RELATIONSHIP | WORK PHONE

COMPLETE FOR INDIVIDUAL IN WHOSE NAME ACCOUNT IS TO BE ISSUED

PRESENT EMPLOYER	HOW LONG	PRESENT EMPLOYER	HOW LONG
EMPLOYER'S ADDRESS	BUSINESS PHONE	EMPLOYER'S ADDRESS	BUSINESS PHONE
POSITION	ANNUAL SALARY	POSITION	ANNUAL SALARY
PREVIOUS EMPLOYER	HOW LONG	PREVIOUS EMPLOYER	HOW LONG
ADDRESS	BUSINESS PHONE	ADDRESS	BUSINESS PHONE
POSITION	ANNUAL SALARY	POSITION	ANNUAL SALARY

Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.

Other income (such as AFDC, Social Security or other public assistance benefits, alimony, child support, part-time employment, retirement benefits, etc.)

Other income: $ per	Other income: $ per
Source(s) of other income	Source(s) of other income
BANK AND BRANCH–CHECKING–ACCOUNT NUMBER	BANK AND BRANCH–CHECKING–ACCOUNT NUMBER
BANK AND BRANCH–SAVINGS–ACCOUNT NUMBER	BANK AND BRANCH–SAVINGS–ACCOUNT NUMBER

CREDIT REFERENCES (STORES, CREDIT CARDS, BANK LOANS, ETC.) GIVE ACCOUNT NUMBERS

CREDIT REFERENCE ACCOUNT NUMBER	CREDIT REFERENCE ACCOUNT NUMBER
CREDIT REFERENCE ACCOUNT NUMBER	CREDIT REFERENCE ACCOUNT NUMBER
SIGNATURE DRIVER'S LICENSE NUMBER AND STATE	SIGNATURE DRIVER'S LICENSE NUMBER AND STATE

☐ **CHECK HERE IF YOU WISH TO APPLY FOR YOUR SIX-MONTH FREE HOT-LINE MEMBERSHIP.**

HOT-LINE CREDIT CARD PROTECTION SERVICE: If your application is approved, you are eligible to receive the Hot-Line credit card services described on the other side . . . at no cost whatever for six months. Following your six-month free membership, you may automatically continue your Hot-Line services for just $12 per year. You will receive advance notification prior to expiration and you may cancel at any time. Membership dues will be billed to your credit card account for your convenience, but your acceptance of the six-month free membership in no way obligates you to continue beyond six months.

MOISTEN, FOLD OVER AND SEAL

(1-2) 40

bloomingdale's

CHARGE ACCOUNT

INSTRUCTIONS FOR COMPLETING THE CREDIT APPLICATION

INDIVIDUAL ACCOUNT:
If an individual account is requested, sections I and III should be completed and signed. Only your own creditworthiness will be considered.

JOINT ACCOUNT:
If a joint account is preferred, Sections I, II and III must be completed. The creditworthiness of both persons may be considered and both will be responsible for payment.

Category of account requested (check one) ☐ INDIVIDUAL ☐ JOINT } see instructions above for completing the application.

SECTION I — For all accounts complete the personal information about yourself.

YOUR FIRST NAME	MIDDLE INITIAL	LAST NAME (PLEASE PRINT)	AGE	HOME PHONE NUMBER

PRESENT ADDRESS — NUMBER & STREET	APT	CITY	STATE & ZIP	CHECK ONE ☐ RENT ☐ WITH PARENTS ☐ OWN ☐ ROOMING	HOW LONG
FORMER ADDRESS — NUMBER & STREET	APT	CITY	STATE & ZIP	CHECK ONE ☐ RENT ☐ WITH PARENTS ☐ OWN ☐ ROOMING	HOW LONG

PRESENT EMPLOYER — COMPANY NAME	ADDRESS	POSITION	HOW LONG	SALARY	PHONE NUMBER	
FORMER EMPLOYER — COMPANY NAME	ADDRESS	POSITION	HOW LONG	SALARY	PHONE NUMBER	

ADDITIONAL INCOME — SOURCE You need not disclose income from alimony, child support or maintenance payments unless you wish such income considered for credit	AMOUNT	SOCIAL SECURITY NO.	FORMER BLOOMINGDALE'S ACCOUNT	☐ YES IF YES — NAME, ADDRESS, ACCOUNT NO. ☐ NO

BANK ☐ REG. ☐ SP — CHECKING BANK NAME	ADDRESS OF BRANCH	ACCOUNT NO.	OUTSTANDING LOANS	AMOUNT OWING
REFERENCE — SAVINGS BANK NAME	ADDRESS OF BRANCH	ACCOUNT NO.	LIST STORE REFERENCES	ACCOUNT NO.
PERSONAL REFERENCE — NAME	ADDRESS			

AUTHORIZED USERS
1 2 3

SECTION II — For joint accounts, complete the information about the other person responsible.

YOUR FIRST NAME	MIDDLE INITIAL	LAST NAME (PLEASE PRINT)	AGE	HOME PHONE NUMBER

PRESENT ADDRESS — NUMBER & STREET	APT	CITY	STATE & ZIP	CHECK ONE ☐ RENT ☐ WITH PARENTS ☐ OWN ☐ ROOMING	HOW LONG
FORMER ADDRESS — NUMBER & STREET	APT	CITY	STATE & ZIP	CHECK ONE ☐ RENT ☐ WITH PARENTS ☐ OWN ☐ ROOMING	HOW LONG

PRESENT EMPLOYER — COMPANY NAME	ADDRESS	POSITION	HOW LONG	SALARY	PHONE NUMBER	
FORMER EMPLOYER — COMPANY NAME	ADDRESS	POSITION	HOW LONG	SALARY	PHONE NUMBER	

ADDITIONAL INCOME — SOURCE You need not disclose income from alimony, child support or maintenance payments unless you wish such income considered for credit	AMOUNT	SOCIAL SECURITY NO.	FORMER BLOOMINGDALE'S ACCOUNT	☐ YES IF YES — NAME, ADDRESS, ACCOUNT NO. ☐ NO

BANK ☐ REG. ☐ SP — CHECKING BANK NAME	ADDRESS OF BRANCH	ACCOUNT NO.	OUTSTANDING LOANS	AMOUNT OWING
REFERENCE — SAVINGS BANK NAME	ADDRESS OF BRANCH	ACCOUNT NO.	LIST STORE REFERENCES	ACCOUNT NO.
PERSONAL REFERENCE — NAME	ADDRESS			

(112) 47

Apply for Charg-all today ...it's easy!

Just mail us the application below, or stop in at the Wards Store nearest you and complete the application in person.

Now—apply by phone with our new TOLL-FREE number!

CALL (800) 231-5776 (for credit applications only)

Read agreement on page 580, complete and sign this application. Then snip out this page, and bring or mail to Wards.

In submitting this application I authorize you to investigate my credit record and if an account is established for me, furnish information concerning my credit file to consumer reporting agencies and other proper recipients. Finance charges will be made in amounts or at rates not in excess of those permitted by law.

F81 (Source Code 713)

(PLEASE PRINT)

TELL US ABOUT YOURSELF 1

FIRST NAME | INITIAL | LAST NAME | AGE | HOME PHONE (Area Code) | NO. OF DEPENDENT CHILDREN | SOC. SEC. NO.

OWN ☐ RENT ☐ BOARD ☐ MOBILE HOME ☐ PARENTS ☐ OTHER ☐ | AMOUNT OF MONTHLY RENT OR MORTGAGE PAYMENT $

PRESENT ADDRESS | CITY | STATE | ZIP CODE | YEARS AT THIS ADDRESS

PREVIOUS ADDRESS | CITY | STATE | ZIP CODE | YEARS AT THIS ADDRESS

OCCUPATION OR RANK | PRESENT EMPLOYER | TYPE OF BUSINESS | YEARS WITH EMPLOYER

EMPLOYER'S ADDRESS | CITY | STATE | ZIP CODE | PHONE

PREVIOUS EMPLOYER | YEARS AT | Information about alimony, child support or maintenance payments need not be disclosed. | APPLICANT'S TOTAL GROSS INCOME PER MO. (all sources) $

ARE YOU A CITIZEN OF THE U.S.A.? ☐ YES ☐ NO | IF NOT, ALIEN REGISTRATION #1-551 NUMBER | I-94 NUMBER

DO YOU NOW HAVE LIFE INSURANCE? PERSONAL ☐ GROUP ☐ NONE ☐ | EDUCATION COMPLETED ☐ HIGH SCHOOL ☐ SOME COLLEGE ☐ COLLEGE GRAD | MODEL YEAR(S) OF AUTO(S) '19____ '19____

TELL US ABOUT YOUR CREDIT REFERENCES 2

Information about your Bank, Credit Union or Savings & Loan: INSTITUTION NAME AND BRANCH | CHECKING ☐ SAVINGS ☐ LOAN ☐ | ACCT. NUMBER

INSTITUTION NAME AND BRANCH | CHECKING ☐ SAVINGS ☐ LOAN ☐ | ACCT. NUMBER

CUT ALONG THIS LINE

LIST CREDIT REFERENCES: Incl. bank and travel cards, finance companies, charge accts., oil companies, etc. Use separate sheet if needed.

FIRM NAME	LOCATION	ACCT. NO.	EXACT NAME ON ACCT.	MONTHLY PAYMENT	PRESENT BALANCE

PREVIOUS WARDS ACCOUNT? YES ☐ NO ☐ IF YES, GIVE ACCT. NO. AND/OR LOCATION:

INFORMATION ABOUT SPOUSE (optional) 3

Provide the information only if your spouse is authorized to buy on this account or if you are relying on your spouse's income as a basis for payment.
Do you authorize your spouse to use this account? YES ☐ NO ☐

SPOUSE'S NAME | OCCUPATION | EMPLOYER | YRS. AT THIS JOB | GROSS INCOME PER MO. $

EMPLOYER'S ADDRESS | CITY | STATE | ZIP | BANK | CHECKING ☐ SAVINGS ☐ LOAN ☐

In addition to my spouse (if any), I authorize the following to use my account:

In submitting this application I authorize you to investigate my credit record and, if an account is established for me, furnish information concerning my credit file to consumer reporting agencies and other proper recipients.

I have read the Charg-all agreement set out on pg. 580 and agree to the terms and conditions thereof.

SIGNATURE AND AUTHORIZED USERS 4

NAME | ADDRESS | SIGNATURE X | DATE

NAME | ADDRESS | SIGNATURE X | DATE

Initial here_____ If you do not wish to receive any of the special merchandise and service offers described in paragraph III on page 580, APPLICANT'S DRIVER'S LICENSE NO.

WARDS CHARG-ALL INSURANCE AGREEMENT 5

I desire Wards Group Charg-all Security Plan Insurance (CSP) or Wards Group Credit Life Insurance (CIP) in those states authorized, as described on pg. 581, and in accordance with the terms stated in the Certificates of Insurance to be sent me which are issued by Montgomery Ward Life Insurance Co. for life benefits and Central National Insurance Co. of Omaha for other benefits. The cost of CSP is .0050 of my previous balance each month. The cost of CIP is .0015 of my previous balance each month. Both plans are voluntary. If available elsewhere, insurance may be obtained through a person of my own choosing and I may cancel at any time.

APPLICANT'S SIGNATURE | AGE (not eligible if age 65 or over in CIP states)

SPOUSE'S SIGNATURE | DATE

WARDS 579

Senator HEFLIN. The subcommittee will stand in recess, subject to the call of the Chair.

[Whereupon, at 12:30 p.m., the hearing was recessed, subject to the call of the Chair.]

○